

MINUTES

INVESTMENT COMMITTEE MEETING MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

One McInnis Parkway, 1st Floor
Retirement Board Chambers
San Rafael, CA

November 18, 2009 11:00 A.M.

EVENT CALENDAR 11:00 A.M. – Investment Committee Meeting

CALL TO ORDER Trustee Haim called the meeting to order at 11:27 A.M.

ROLL CALL PRESENT: Arrigoni, Bolger, Given (non-voting), Gladstern, Haim, Hufford (late arrival), Phillips (late arrival), Smith, Sweet, Webb (non-voting), Wofford (non-voting)

ABSENT: Richardson

A. OPEN TIME FOR PUBLIC EXPRESSION

B. MANAGER ANNUAL REPORTS

1. Numeric Investors – Market Neutral

Mike Evan, Chief Executive Officer of Numeric Investors, gave a review of recent portfolio results of negative 7.9% year-to-date and negative 7.1% for 2008, which he acknowledged were substandard. Mr. Evan allowed that the firm had lost two clients recently due to underperformance, adding that 2008 and 2009 were unusually challenging market environments. He said that in April recovery began with the small cap sector lagging but also showing recovery. He expressed confidence in a sustainable portfolio turnaround to historical levels. He introduced Greg Bond, Portfolio Manager for the U.S. Market Neutral portfolio.

Trustees Given and Webb were excused from the meeting at 12:30 P.M., rejoining at 12:35 P.M.

Trustee Gladstern was excused from the meeting at 12:30 P.M., rejoining at 12:40 P.M.

Mr. Bond explained the investment approach to be a balance between identifying value stocks with fundamental analysis and investor sentiment. The sector-neutral strategy is to short stocks which are trending down, and buy value stocks which are trending up; however, the portfolio manager allowed that this model has not performed well, with the V-shaped recovery being particularly damaging to the firm's strategy. Mr. Bond stated that while determining value opportunities has been difficult over the past year due to market volatility, the firm's approach has been to maintain the same strategy over the short term.

Trustee Arrigoni asked what an inter-quantile model was and the manager explained it as buying the top 20% and shorting the bottom 20%. Currently market signals are normalizing and the firm expects this to continue, according to Mr. Bonds. Callan Associates Investment Consultant Lin Fitzenhagen questioned the firm's strategy based on the underperformance of the past year, suggesting that the paradigm needs to change. It was noted that hedge fund flows had a major impact on the poor returns. Trustee Gladstern asked the firm's representatives why MCERA should continue to invest in the market neutral area. Mr. Evan maintained that in spite of significant periods of underperformance in recessionary periods, the firm believes in the quantitative strategy. Trustee Gladstern pointed out that returns have not exceeded the benchmark since 1996.

2. Pyramis Global Advisors – Market Neutral

Bryon Hoesly, Pyramis Global Advisors Institutional Portfolio Manager, stated that the U.S. Market Neutral portfolio absolute returns exceeded 8% over the past year, and exceeded the benchmark over the long term, with the exception of the third quarter of 2008. Mr. Hoesly summarized the firm's investment strategy as based on the relatively high turnover of investments possessing strong fundamentals and a low correlation to other asset classes. Areas of outperformance over the past quarter included transportation, shipping, infrastructure, fast food and consumer discretionary; short positions added value where demand was low, such as casual dining.

Trustee Gladstern was excused from the meeting at 1:25 P.M., rejoining at 1:32 P.M.

Moving forward, the firm sees significant valuation dispersion between small and large capitalization ("cap") investments; therefore, the Portfolio Manager is favoring large cap at this time. While Mr. Hoesly described staffing as stable, Consultant Fitzenhagen encouraged the dispersment of the Portfolio Manager's acumen.

3. Analytic Investors – U.S. Market Neutral

Brian Haskin, Managing Director, Marketing and Client Service, for Analytic Investors, stated that over the past year returns for both the U.S. and Japan portfolios are down close to 5%, under-performing the benchmark. Mr. Haskin stated that due to market volatility the firm reduced staff by 10%, including investment staff.

Trustees Arrigoni and Haim were excused from the meeting at 1:40 P.M., rejoining at 1:46 P.M.

Consultant Fitzenhagen asked Mr. Haskin if the low-volatility, low-beta paradigm was still valid given the acute underperformance recently. Mr. Haskin replied by explaining that the model typically underperforms during recessionary periods. He then introduced Dennis Bein, Chief Investment Officer and Portfolio Manager.

Trustee Sweet was excused from the meeting at 1:45 P.M. and returned at 1:50 pm.

Trustee Bolger was excused from the meeting at 1:54 P.M and returned at 2:00 P.M.

Mr. Bein discussed price momentum and the fact the firm's quality bias was the reason for recent underperformance as the recent rally has been in low-quality stocks.

Trustee Gladstern was excused from the meeting at 2 P.M., rejoining at 2:03 P.M.
Trustees Phillips and Hufford joined the meeting in session at 2:05 P.M.

Going forward he expects the market environment to favor value stocks, which in the recent market rally had been left behind. He reiterated that in post-recessionary periods value investments should outperform high risk investments.

Trustee Arrigoni was excused from the meeting at 2:15 P.M., rejoining at 2:18 P.M.

4. Analytic Investors – Japanese Market
Report included in Item 3 above.
5. First Quadrant – European Market Neutral Equity

Referring to “idiosyncratic risk” in the U.S. and global markets, Susan Stannard, First Quadrant Relationship Manager, acknowledged that the portfolio's returns have not met the stated goal of “generating alpha returns independent of the market's direction” recently. She outlined a litany of struggles including the loss of clients, a 15% work force reduction, and a demanding new trading system. It was apparent that the recent market decline and high volatility did not favor the firm's quantitative model, and the firm is trying to make adjustments. The current model uses a top-down approach and looks to take advantage of perceived market inefficiencies. Ms. Stannard claimed that the model can perform well as the market stabilizes, but struggles at market inflection points. Portfolio returns over the past three years range between negative 4.2% and negative 5.6%

Paul Brennan, Portfolio Manager, European Market Neutral Equity, referred to the distressed subprime market, the Lehman bankruptcy, and other “market disruptions” as factors negatively affecting performance. The narrow nature of the recent market rally and shorting restrictions also contributed to poor performance, he added. Mr. Brennan allowed that the firm's model (stock selection using trend analysis - investing according to fundamentals and favoring earnings quality) was not working, especially in the second quarter, which inspired adjustments including acquiring higher ranked stocks on the long side and shorting lower ranked stocks. The manager stated that the firm is making strategy adjustments in market timing to improve returns.

Trustee Haim was excused from the meeting at 2:25 P.M., rejoining at 2:27 P.M.

C. **INVESTMENT CONSULTANT QUARTERLY REPORT**

For period ending September 30, 2009

Investment Consultant Lin Fitzenhagen, CFA, of Callan Associates, reported that the firm was monitoring the Barclays - BlackRock merger, and noted that the recent Morgan Stanley divestiture would not affect the fund. Mr. Fitzenhagen reported that the recent capital markets rally has resulted in substantial third quarter portfolio returns of close to 12%. He reviewed the recovery in the U.S. economy and discussed the high price of gold. He pointed out that small, mid-value and growth sectors have recovered well from March 2009 lows. Notable performers were Dodge & Cox, small capitalization stocks, and Artisan; fixed income was up 6%. International equity returns were impressive, with the exception of Japan. Real estate values have underperformed, causing a drag on the portfolio, but remain in line with the benchmark. As the market-neutral portfolio returns are disappointing for the last year in particular, Mr. Fitzenhagen explained that Callan planned to develop a work plan to evaluate the situation. Noting that shorting restrictions in the European financials negatively impacted the market-neutral portfolios, the consultant surmised that emerging markets shorting restrictions would ease as these markets mature.

Trustee Gladstern was excused from the meeting at 2:50 P.M., rejoining at 2:51 P.M.

Trustee Hufford was excused from the meeting at 2:42 P.M., rejoining at 2:50 P.M.

Trustee Haim was excused from the meeting at 2:49 P.M. to attend to another commitment.

Chair Phillips stated that it appeared that the recent market turmoil was unusual and asked Mr. Fitzenhagen whether the managers would be able to adapt to similar market turmoil in the future. The Investment Consultant advised evaluating the quantitative managers in light of recent underperformance.

D. **NEW BUSINESS**

1. **Consider and discuss possible write-down of RREEF America III**

Sarah Angus, Callan Associates Vice President, Real Estate Consulting Services, presented an update on the ailing RREEF America III portfolio based on the December investor meeting as well as the third-quarter conference call. She reported that currently debt restructuring for \$1.4 billion (\$1.2 billion secured) is the focus of attention, with agreement-in-principal reached on the majority of the debt. For the unsecured line of credit, a one-month extension was negotiated with a three-year extension planned. The firm is mollifying restless clients by reducing fees, although recently hired consultants will mitigate the effect. Ms. Angus reported that ten properties have been returned to lenders, including the distressed Sunnyvale investment. Investors have placed a representative on the Board, she said. It was noted that real estate values continue to trend down but show signs of stabilizing.

It was agreed to continue consideration of the RREEF matter to a later date in favor of additional information.

There being no further business, the meeting was adjourned at 2.55 P.M.

Allen Haim, Trustee

Attest: Thomas C. Ford
Acting Retirement Administrator