

MINUTES

INVESTMENT COMMITTEE MEETING MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

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

January 14, 2010 - 9:00 A.M.

EVENT CALENDAR 9:00 A.M. – Investment Committee Meeting

CALL TO ORDER Chair Richardson called the meeting to order at 9:04 A.M.

ROLL CALL PRESENT: Arrigoni, Bolger, Gladstern, Haim, Phillips, Richardson,
Sweet, Webb (non-voting)

ABSENT: Given (non-voting), Smith, Hufford, Wofford (non-voting)

A. OPEN TIME FOR PUBLIC EXPRESSION

B. MANAGER ANNUAL REPORTS

1. BlackRock

Lee Wanie, Director, CFA, Client Relationship Officer for BlackRock, addressed the Board and introduced Prentice Ng, Vice President, and Dan Blumhardt, CFA, Director and Investment Strategist. In the face of difficult market conditions and disappointing performance, Mr. Wanie assured the Trustees of the firm's adaptability. Mr. Wanie reviewed the merger of Barclays Global Investors (BGI) with BlackRock. Affirming that the BGI culture is alive and well within BlackRock, he ceded the floor to Mr. Ng to provide additional merger details.

Mr. Ng stated that the merged firm boasts assets under management of \$3.2 trillion and a history of continuous leadership and successful acquisitions. The global presence allows for delivery of extensive resources to clients, and BGI complements BlackRock by providing in-depth quantitative resources, according to Mr. Ng. No change in the active equity team in San Francisco resulted from the merger, he said.

The firm reported a return of 24.4% for 2009 which was 2% below the benchmark, and a three-year annualized return of negative 7.7%, also 2% below the benchmark. Allowing that performance has been a challenge recently, Mr. Wanie stated that the firm will differentiate itself by generating good proprietary investment strategies going forward. He sees the market returning to a more normal environment of less stock correlation and a broad dispersion in valuations which allows for active-management performance.

To Trustee Phillips' query regarding relative performance compared to peers, Mr. Wanie replied that performance was average. Investment Consultant Jim Callahan of Callan Associates explained that generally speaking recent outperformance was limited to those firms utilizing non-quantitative strategies; in the recent volatile, choppy market environment, he said, quantitative approaches struggled. Only trending markets tend to favor the quantitative approach, the consultant explained. Mr. Wanie introduced Dan Blumhardt to review the Alpha Advantage 500 portfolio.

According to Mr. Blumhardt, the portfolio strategy is to build diversified multiple small positions comprising a partial long/short quantitative vehicle aligned with the S&P 500. He stated that the firm has been a pioneer in using quantitative models to identify investment opportunities which maximize returns while minimizing costs. Stock selection is by fundamental analysis followed by modeling based on the three themes of relative value, earnings quality, and sentiment. Trustee Arrigoni queried the strategist as to the wisdom of remaining with the approach as opposed to investing directly in the S&P 500; Trustee Gladstern voiced displeasure that fees were higher for this portfolio, while returns underperformed the prior lower-fee model. Mr. Blumhardt replied that over time performance will be realized and the firm continues to develop resources and data correlations to create a robust platform.

Trustee Gladstern was excused from the meeting at 9:50 P.M., returning at 9:54 P.M.

2. Western Asset

Aaron Prince, Western Asset Management Client Services Specialist, reported recent staff and process enhancements and reviewed recent performance in a difficult market environment evolving from the global credit crisis in 2008. Notwithstanding noted difficult market forces, the firm generated a portfolio return of 23.3% in 2009, rebounding from a 13.9% loss in 2008. The 2009 return was 17.4% ahead of the benchmark. Mr. Prince said that while the firm has recovered losses in recent years, the firm's strategy as a long-term fundamental value manager has been challenging due to difficulty in determining value. Mr. Prince introduced James So, CPA, CFA, to provide an in-depth portfolio review.

During 2008 the fixed income environment was "atrocious," Mr. So stated, with one three-month period accounting for 85% of the underperformance for the entire year. The crisis was severe, but the firm anticipated growth following the Federal Reserve's (the "Fed") approach to mitigate the financial crisis; as a result, Mr. So explained, the firm increased investments as values cratered. This strategy successfully broke the negative feedback loop, he stated.

Mr. So stated that he expects the Fed to tighten rates during the third quarter of 2010 at the earliest. Trustee Phillips inquired as to inflation expectations, but the manager stated he did not expect inflation to occur due to the current weak economic environment. Currently rate spreads are returning to historic averages, he said, with a projected default rate of 4 to 5% for 2010. He expects home prices to continue to decline 15% nationally during the current year.

The largest sector bet is currently the finance sector, especially large money center banks, according to Mr. So. For investment-grade investments, Wells Fargo is the largest position, with Ford representing the largest position in the high-yield space. Removal of the Federal program supporting agency mortgages will create problems, according to Mr. So, so he favors non-agency positions at this time.

3. Wellington

Elise Carner, CFA, Vice President and Account Manager for Wellington Management Company, reported that the firm continues to acquire new clients. The firm bases investment selections on the two main parameters of duration posture vis-à-vis interest rates and relative value between sectors. She reported that favoring the securitized and financial sectors contributed to recent positive performance. The firm reported a 2009 return of 14.4%, well ahead of the 5.9% benchmark return, and a three-year return of 6.1%, slightly ahead of the benchmark.

Due to the move from Core to Core Plus, Campe Goodman will manage the portfolio going forward, she said. Duration will be neutral with a short bias as rates are expected to rise, she said. The firm favors money center banks, while it is underweight government issues as agency mortgage-backed security values are expected to decline; corporate bonds are still attractive, according to Ms. Carner. Consumer-related and utility issues are underweighted at this time, she added.

During the portfolio transition from Core to Core Plus, Ms. Carner expects 15 to 30 basis points in transition costs. Consultant Jim Callahan pointed out that the move to Core Plus will have a positive effect by providing for a broader security pool as well as a higher yield.

C. INVESTMENT CONSULTANT QUARTERLY REPORT

For period ending September 30, 2009

Investment Consultant Jim Callahan provided for an updated review of the portfolio in addition to the prior quarterly review, noting that assets recovered recently to just under \$1.2 billion, with out-performance to the benchmark achieved. Notably, Dodge & Cox and RCM out-performed their sectors, he said. Rebalancing between these two portfolios is warranted, he said. In the small cap area, there is currently an overweight to value that should also be rebalanced. While final 2009 results are not yet available, Mr. Callahan stated that he expected good performance. He reported the portfolio balance to be within policy guidelines, with the long-term strategy of maintaining equal weight between growth and value. Due to a divergence in value between the Wellington and Western Asset fixed income portfolios, however, Mr. Callahan recommended rebalancing the two. The most important area to address going forward is the underperformance of the market neutral category, according to the consultant.

Addressing the reporting method for the private equity portfolio, Mr. Callahan stated that the long-term target allocation is 8%. In order to prevent a large asset allocation distortion

in the target during build-out, the target will reflect the actual value until it reaches 8%, he explained. As fees are being paid on the total committed value, reported returns are negative; however, the impact to the total portfolio is minimal due to the relatively small values.

Chair Phillips noted that over 10 years the portfolio has out-performed the market, highlighting the importance of asset allocation.

Morgan Stanley's relative underperformance is to be expected due to their conservative strategy, according to Mr. Callahan. The London-based team has the new responsibility of global asset management, so they should be monitored to assure retention of their historic independent posture. The move of one of the managers to Singapore seems to be working smoothly, according to the consultant. BlackRock should be monitored in light of the recent underperformance of the former BGI. AXA Rosenberg deserves watch-list status due to disappointing results, with positive performance from the Pyramis portfolio providing for balance.

As to the recent robust recovery of fixed income values, the consultant noted patience was the key. The bondized market-neutral strategy also demands scrutiny, he stated, due to underperformance and high relative cost. In the real estate area, property values continue to suffer; while the unleveraged Woodmont portfolio experienced write-downs, they are considerably less than most real estate managers, the consultant noted. RREEF has made progress in recapitalizing and hopefully there will be some recovery value over a longer period of time, he said. As the Artisan international growth portfolio has a new co-portfolio manager, it will be monitored going forward. Recent outperformance of the portfolio can be attributed in large part to currency values, according to Mr. Callahan.

The discussion turned to the underperformance of the market neutral strategy, which over time has performed in line with cash. The consultant voiced concerns about the First Quadrant and Analytic Japan portfolios. Trustee Haim recommended that the portfolio allocation to the market neutral area be reduced.

There was discussion as to the nature and formality of the watch list and it was generally agreed to keep the watch list flexible so as to provide for changing circumstances. The consultant assured the Trustees that he monitors the portfolio on a daily basis and would provide a watch list summary at the Spring Workshop.

Trustee Gladstern was excused from the meeting at 11:11 A.M., returning at 11:16 A.M.

D. 2010 WORK PLAN

Consider and discuss proposed Work Plan

The Investment Work Plan will be reviewed during the Spring Workshop. Consultant Jim Callahan proposed the following areas of review for 2010: Capital Markets and Asset Allocation; Investment Policy Statement; Asset Class Structure; Portable Alpha Program; Watch List; and Due Diligence on-site visits. Decisions on the first four will comprise the revised work plan for the year, he stated.

Callan Associates is currently developing macro opinions which will drive decisions, according to the consultant. Investment policy should be reviewed thoroughly with an eye toward asset allocation, he said. Mr. Callahan cautioned that expectations for returns from both equities and fixed income will be significantly reduced. The ten-year equity rate of return will be reduced to 8% from 9%; similarly, the bond return rate will be reduced, he said. As to the current industry theme of inflation protection, Mr. Callahan expects spare capacity to deflect such concerns for some time.

Trustee Bolger was excused from the meeting at 12:05 P.M.

E. NEW BUSINESS

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

Administrator Ford recommended that a decision on a possible write-down of the RREEF America III portfolio be deferred, and it was agreed to continue to monitor the situation as no exit strategy is available at this time.

2. Consider date and attendees for Woodmont property tour

Administrator Ford stated that he and Trustees Sweet, Webb, and two other Trustees would attend the annual Woodmont property tour. In addition, Senior Accountant Lisa Jackson will accompany the group.

3. State Street Securities Lending Update

Mr. Callahan reviewed a California lawsuit against State Street, explaining that it involved alleged foreign exchange abuses involving best prices. Missouri filed a lawsuit involving securities lending due to the drop below \$1 in the value of cash collateral; State Street countered with a lawsuit against Missouri claiming gaming of the system. While MCERA is not affected by the foreign exchange litigation, he said, the issue is the effect on State Street's reputation. In securities lending, MCERA has exposure; however, State Street has so far maintained clients' collateral values in spite of some illiquid investments. Mr. Callahan recommended inviting State Street to address the issues before the Investment Committee, and Administrator Ford advised continued monitoring due to the policy of not engaging in litigation below a stated threshold.

There being no further business, the Chair adjourned the meeting at 12:18 P.M.

Gerald Richardson, Chair

Attest: Thomas C. Ford
Acting Retirement Administrator