MINUTES

INVESTMENT COMMITTEE MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

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

January 13, 2011 – 9:00 A.M.

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

ROLL CALL PRESENT: Bolger, Brenk, Gladstern, Haim, McFarland, Phillips, Richardson, Walsh, Webb (non-voting), Wofford

ABSENT: Given (non-voting)

A. OPEN TIME FOR PUBLIC EXPRESSION

No public comment.

B. MANAGER ANNUAL REPORTS

1. Western Asset – Domestic Fixed Income

Western Asset Management Client Services representative Frances Coombs reported that the Core Full Fixed Income portfolio 2010 return was 11.5% vs. 6.5% for the Barclay's Capital U.S. Aggregate Index.

Portfolio Manager Julien Scholnick reviewed the portfolio structure relative to the Barclay's benchmark, advising that he has begun to reduce portfolio risk. He reviewed the portfolio's positions relative to its benchmark's, and the portfolio was about half the index weight in US Treasuries and agency bonds, and slightly underweight the index in the agency mortgage sector. The remaining top four sectors are government-related, he said, and there is a small position in TIPS. Areas overweight to the index include non-agency positions, investment-grade credit, and high yield investments. Mr. Scholnick expects a slow-growth environment with stable to declining interest rates over the short term, with interest rate spreads continuing to compensate for risk.

Trustee Bolger inquired about the make-up of credit default swaps and their investment grade determination. The portfolio manager said that the portfolio contains mainly cash bonds, and investment grades are carefully monitored. Trustee Webb questioned uncommon foreign currency positions, and Mr. Scholnick explained that commingled funds from a few years ago contained some illiquid positions. Investment Consultant Jim Callahan observed that such exposure is limited to less than one basis point of the portfolio.

Mr. Scholnick reviewed the nature of the core-plus mandate to outperform the benchmark by expanding fixed income investments to include currency and currency futures, non-U.S. securities and below-investment-grade securities. He said that returns are positive with some volatility.

Chair Phillips pointed out that the portfolio has performed well, especially coming out of the credit crisis, returning above-benchmark returns over one year and the past quarter.

Trustees Richardson and Brenk questioned the longer-than-benchmark duration, and Mr. Scholnick explained that he expects the yield curve to flatten. Duration is actively managed on a daily basis, he added.

2. Wellington Management – Domestic Fixed Income

Relationship Manager Sue Bonfeld defined Wellington Management as a private partnership managed as a federation of boutiques with a coherent view on interest rates. No impact is expected to emanate from the recent leave of absence of the head of investment research. The U.S. Core Bond Fixed Income portfolio, managed by Portfolio Manager Campe Goodman, has a conservative strategy with no allowance for high yield positions or derivatives. The 2010 portfolio return was 7.72% versus 6.56% return of the Barclay's aggregate index, before the fee of 22.5 basis points.

Ms. Bonfeld said that sector-specific staffing resources are increasing, with compensation based on alpha over 3- and 5-year rolling periods. Duration, interest rates, and sector weightings are discussed at management meetings. Through November the interest rate call detracted from performance, while performance was enhanced in the spread sector.

The portfolio manager expects moderate U.S. growth with contained inflation. Ms. Bonfeld said that more sovereign debt is likely to be issued, and the bond market continues to have potential for price volatility.

Trustee Walsh commented on the volatility of 2008 and 2009 returns, and Callan Associates Investment Consultant Jim Callahan commented that less conservative fixed income portfolios were incrementally more volatile. Mr. Callahan explained that allocation to fixed income is based on the Barclay's Aggregate index. He stated that returns for the fixed income portfolio will be impacted by factors such as active vs. passive management, types of fixed income securities, and return expectations vis-a-vis the benchmark.

Chair Phillips recessed the meeting for a break at 10:30 A.M., reconvening at 10:40 A.M.

C. INVESTMENT PERFORMANCE QUARTERLY UPDATE

For period ending December 31, 2010

Callan Associates Investment Consultant Kevin Dunne reported a total fund value of $1,349 million through November 2010, up 9.37% over the past three months and up 8.84% over the past twelve months. Slight declines in fund value during November due to rising interest rates have since reversed and Mr. Dunne expects to report higher portfolio returns through December 2010, once results are finalized. For the investing environment over the long term, unemployment and sovereign debt continue to be issues, according to Mr. Dunne.

Mr. Dunne reported that asset class allocations are close to targets, with increasing investments in private equity as planned. The recent transition from the BlackRock portfolio to the State Street Global Advisors S&P 500 index fund is complete. There were no major changes to the small cap portfolio.

Trustee Brenk commented on small cap managers' outperformance, which Mr. Dunne attributed to active management based on proprietary strategies. Volatility in the small-cap portfolio is expected. Trustee Brenk asked if the market neutral strategy would be a suitable replacement for fixed income investments; Mr. Callahan replied that the group is competitive in returns but is not correlated to bonds, and thus would not be a suitable substitute.

Chair Phillips discussed the potential of a transition from core to core plus in the Wellington fixed income portfolio. County Counsel Stephen Raab stated that legal issues remain.

D. OLD BUSINESS

1. Update on AXA Rosenberg

   Investment Consultant Kevin Dunne reported that former international small-cap manager AXA Rosenberg was awaiting a response to their coding error report from the SEC. MCERA terminated the investment when a communication gap between the investment team and the management team was revealed. Mr. Callahan reviewed the history of the terminated investment.

   Administrator Wickman stated that the primary goal is to recover management fees. The SEC response may allow for other potential recovery such as losses relating to the coding error. Mr. Wickman stated that the matter will remain on the agenda in order to keep the Board apprised of developments.

E. NEW BUSINESS

1. Consider and take possible action regarding sale of office building at 1851 Heritage Lane in Sacramento, California – Woodmont (**Action**)

   Woodmont Realty Advisors Chairman Ron Granville stated that the real estate portfolio is continually reviewed for potential investments to buy or sell. At this time he believes it is appropriate to sell the Heritage Lane property. The property produced satisfactory returns until 2007, but the Sacramento area has been particularly hard-hit by the recession with increasing vacancies. Mr. Granville requested formal approval to market the property for sale.

Mr. Granville reviewed the relative merits of continuing to upgrade and search for new tenants while keeping the property on the market, versus selling the property now. He also discussed provisions for selling the property and the cost of commissions depending on the number of brokers involved. The absence of like transactions makes determination of value a challenge.

Mr. Granville characterized the proposed sale as a strategic move. Trustee Bolger agreed with the recommendation to offer the property for sale. Chair Phillips discussed aspects of the real estate market with Mr. Granville, who reviewed the factors affecting prospective tenants.

It was M/S Gladstern/Wofford to authorize the Retirement Administrator to work with Woodmont to finalize agreement to market the office building at 1851 Heritage Lane in Sacramento, California for sale. The motion was approved by unanimous vote.

2. <u>Consider and take possible action regarding sale of Argent Securities Bond from securities lending program – Callan Associates (**Action**)</u>

Mr. Dunne reviewed the securities lending program for the benefit of newer trustees. The Argent Securities Bond is a legacy security that was transferred to State Street from prior securities lending agent Bank of New York. Since November 2009, there has been a precipitous drop in the value of the bond. Mr. Dunne said that an analysis by current fixed income managers shows that the current assessed market value is reasonable. At current pricing the expected loss would be approximately $375,000. The loss will need to be recognized in any case, and the question is whether to sell the security.

Trustee Bolger reviewed the custodial history and questioned why the security was accepted during the original transition in custodians. Mr. Callahan said that the transition would not have been able to go forward without the illiquid security. Trustees Bolger, Haim and Richardson recommended staff and counsel research the transition of the bond from the custodian and identify whether MCERA can be made whole by either the current or prior custodian without suffering a loss.

Trustee Walsh asked about the risk associated with securities lending. Mr. Dunne stated that the State Street program has adopted more conservative collateral investment guidelines in order to be more focused on principal preservation and the program has generated positive returns since inception and continues to perform well. Mr. Callahan observed that many of the securities lending programs took too much risk with the collateral investments prior to the credit crisis, and that the Argent security is unique.

Chair Phillips recommended that Administrator Wickman work with counsel to research the legal options available. Mr. Phillips expects that potential for losing additional value is high, and he recommended that the legal cost of pursuing a remedy against the loss in value of the security be determined by counsel and the investment consultant.

3. <u>Portable Alpha (market neutral) Strategies Discussion</u>
Chair Phillips stated that the $75 million market neutral program has been reduced from five managers to three, and the question is whether to continue with the program and its remaining managers, Analytic Investors, Numeric Investors, and Pyramis Global Advisors.

Chair Phillips recessed the meeting for a working lunch at 12:13 P.M., reconvening at 12:33 P.M.

Mr. Dunne reviewed the market neutral strategy, which was originally designed to provide a diversified means of adding return to the portfolio. Disappointing performance as well relatively high fees and the complexities associated with the program were cited as some of the challenges with retaining the program.

The discussion included Trustee Haim’s observation that considerable time has been expended to comprehend and administer the complex program. Trustee Bolger stated that investment returns from the market neutral group are not high enough to justify the added risk and volatility. Trustee Phillips concurred with her assessment, noting that returns are lower than equities but with similar risk.

Chair Phillips and Retirement Administrator Wickman agreed to present an action item on the matter at the February Board meeting.

There being no further business, Chair Phillips adjourned the meeting at 1:03 P.M.

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Jim Phillips, Chair	Attest: Jeff Wickman Retirement Administrator