

## MINUTES

### INVESTMENT COMMITTEE MEETING MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

One McInnis Parkway, 1<sup>st</sup> Floor  
Retirement Board Chambers  
San Rafael, CA

September 15, 2011 – 9 A.M.

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**CALL TO ORDER** Chair Phillips called the meeting to order at 9:00 A.M.

**ROLL CALL** PRESENT: Bolger, Brenk, Given, Gladstern, McFarland, Phillips,  
Webb, Wofford

ABSENT: Haim, Richardson

**A. OPEN TIME FOR PUBLIC EXPRESSION**

Note: The public may also address the Committee regarding any agenda item when the Committee considers the item.

No public comment.

**B. INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE**

For period ending June 30, 2011

Investment consultant Kevin Dunne, CFA, Callan Associates Vice President, reported that the MCERA Fund returned 1.38% (versus 1.06% for the composite benchmark) in the quarter ending June 30, 2011. For the fiscal year ending June 30, 2011, the Fund returned 23.53% (versus 22.58% for the composite benchmark). Both returns exceeded public fund median returns. According to Callan Associates Executive Vice President Jim Callahan, CFA, the Fund's performance is primarily a result of the portfolio's equity allocation. Mr. Callahan discussed alternative investments as a method for further diversifying the portfolio during challenging economic and capital market conditions. The Fund will conduct an Asset Liability review and review alternative asset allocations at the Strategic Planning Workshop in late September.

Mr. Dunne reported that most asset classes contributed to positive returns during the quarter. The international equity portfolio is performing well, he stated, with Eaton Vance Emerging Markets investments outperforming the benchmark. Also, fixed income investments performed well relative to the benchmark and to peers. In summary, Mr. Dunne indicated that the advance in equities since August of 2010 has resulted in a slight overweight to the domestic equity allocation which the Committee may want to address, although he stated the recent equity decline will likely have brought the allocation back

towards target. Mr. Dunne provided an unaudited Flash Report which provided estimated returns for each of the Fund's managers for the month, quarter and year-to-date through mid-September. He provided a high-level overview of the market environment and discussed the decline in equities and an advance in the fixed income portfolio. Duration and an under-allocation to U.S. Treasuries account for fixed income managers' underperformance relative to the benchmark; however, the Treasury rally was captured by the Clifton futures overlay program.

Chair Phillips directed deliberations to **NEW BUSINESS, Agenda Items D.4 and D.3.**

#### **D. NEW BUSINESS**

4. Securities Lending Education Session – Callan Associates, Bo Abesamis  
Bo Abesamis, Callan Associates Executive Vice President, provided an overview of key elements of securities lending, its function in the capital markets, and associated risks. Stressing the importance of risk management over revenue generation, Mr. Abesamis advised using four parameters to structure a securities lending program. First, he recommended the value of securities on loan be limited to one third of portfolio value as required by the SEC. Secondly, he recommended maintaining a tradable lot of securities on loan in the portfolio allows for tracking of corporate actions. Third, cash and non-cash collateral reinvestment guides are provided. Finally, lendable securities are assessed based on an intrinsic value test.

In the aggregate, risk should be measured against expected return, according to Mr. Abesamis. He also advised that efficiencies in securities lending are directly related to portfolio value and may, therefore, not be realized in portfolios below a certain value. Trustee Bolger discussed the settlement and accounting of trades with Mr. Abesamis.

Chair Phillips requested an action item regarding the securities lending program for the next Investment Committee meeting.

3. Foreign Currency Trading Education Session – Callan Associates, Bo Abesamis  
Mr. Abesamis provided an overview of factors affecting foreign currency trading associated with international investments. Since many international managers do not have foreign currency trading resources, he stated, they tap their custodial bank's currencies, which is a capital cost. The cost to repatriate currency is quantity-driven, he said. A central factor involves contractual settlement, whereby the custodian bank guarantees settlement of the transaction. Mr. Abesamis addressed the expectation of best execution and the pooled nature of international assets. He observed that investment managers are aware that currency transactions may affect investment performance. In summary, Mr. Abesamis recommended confirmation of best execution, adequate reporting by custodial banks, and continued communication and education.

Trustee Bolger requested that investment managers certify to best execution on an annual basis. Mr. Callahan stated that managers have been asked to address the foreign currency exchange issue, and he will address reporting as a follow-up.

Chair Phillips directed deliberations to **Agenda Item D.1.**

1. RCM Large Cap Select Growth (Action)

Consider and take possible action to change RCM portfolio strategy to Large Cap Select Growth

Peter Sullivan, RCM Relationship Manager, said that the discussion concerns transitioning the current core growth fund to the select growth fund with a benchmark of the Russell 1000 Growth Index. Mr. Sullivan introduced Scott Migliori, RCM Chief Investment Officer and Chief Portfolio Manager of the U.S. Large Cap Select Growth fund, who described the select growth strategy as being more growth-focused, with more exposure to technology and less to financial services.

The select growth strategy's long-term benchmark outperformance was driven by stock selection, according to Mr. Callahan, and justifies the expected added volatility. Chair Phillips advised that, in addition to performance, diversification is a central reason for considering the move to select growth.

Chair Gladstern asked about added cost, and Mr. Sullivan projected a cost of 9 to 10 basis points to transition the portfolio, with no change in investment management fees.

It was M/S Gladstern/Bolger to change the RCM portfolio strategy to Large Cap Select Growth subject to mitigation of transaction costs. The motion was approved by unanimous vote.

Chair Phillips recessed Open Session for a break at 10:29 A.M, reconvening at 10:42 A.M. and directing deliberations to **Agenda Item D.5.**

5. Core Real Estate Investment Manager Selection (Action)

(TIME CERTAIN: 10:30 A.M.)

Consider and take possible action to select new core real estate investment manager

Sarah Angus, real assets consultant with Callan Associates, said that candidates for core real estate manager were selected for low leverage and stability over time. Cornerstone and Heitman funds are newer and smaller with shorter entry queues, she stated, whereas JP Morgan and UBS funds are established with longer entry queues. In general, core portfolios hold properties that are 90% leased with returns coming from cash flow. There was discussion that no change to the target real estate allocation would be necessary as the group is currently under allocated.

Mr. Callahan distinguished between investing in an older, larger fund versus one of the newer funds. Ms. Angus said that entry into older funds may take years, and that investing in the smaller funds would occur over a shorter time frame.

a. 10:30 A.M. - Cornerstone Real Estate Advisors – Patriot Fund

Pat Kendall, Cornerstone Real Estate Advisors Senior Director of Client Relations, reviewed the structure of the Mass Mutual global real estate firm based in Hartford, Connecticut. Portfolio Manager Brian Murdy stated that the Patriot Fund was formed seven years ago and that entry is available by January 1, 2012. Currently there are 33 diversified investments valued quarterly and reviewed by an outside analyst. Current leverage is effectively 15%. Mr. Murdy highlighted research which holds veto power on the investment committee.

Mr. Murdy stated that based on risk-adjusted return, fund holdings are 85% invested in barrier markets in the Boston to Washington, D.C., corridor, and in California. Apartments represent the largest holdings at 35%. Mr. Murdy reviewed portfolio holdings and exit strategies. Green initiatives are implemented if there is an economic benefit, he said. For stability, Mr. Murdy invests in grocery stores and uses longer term leases. Rotational markets are used as short-term investment strategies, he stated.

The fund has outperformed over three and five years, according to Mr. Murdy, and he emphasized the core nature of holdings, low leverage over time, and access to management. Mr. Murdy discussed succession planning in response to Trustee Brenk's query.

- b. 11:10 A.M. - Heitman Capital Management – America Real Estate Trust  
Christina Polito, Heitman Capital Management Senior Vice President, stated that the Chicago-based firm has a joint 50/50 ownership structure between employees and Old Mutual PLC. The investment process is collaborative with oversight by an investment committee which has decision-making authority.

According to Senior Portfolio Manager Dave Perisho, the America Real Estate Trust was initiated in 2007 as a core real estate fund with limits on value-added investments and maximum leverage of 30%. There is an entry queue of six months for new investors. Quarterly valuations determined by a third party appraiser are reviewed by an internal evaluation committee based on ten-year cash flow projections. Mr. Perisho said that the fund is overweight apartments and underweight to office space relative to the core real estate benchmark. Storage is an area of expertise, he stated, and has provided stable income and benchmark outperformance. The fund is 93% leased, including storage properties, and 97% leased without storage. The geographic focus is the mid-west.

Since inception dividends have been paid every quarter, according to Mr. Perisho, and the fund has outperformed the benchmark. He attributed performance to low leverage and low-risk. It is expected that a succession planning process will be initiated in the next year.

Chair Phillips recessed Open Session for a working lunch break at 12:10 P.M., reconvening at 12:39 P.M.

c. 11:50 A.M. - JP Morgan – Strategic Property Fund

JP Morgan Vice President Brian Ralph stated that the Strategic Property Fund is well-diversified with low leverage. Mr. Ralph introduced Amy Cummings, Executive Director for Client Relations, who reviewed the firm's management and investment team structure.

Dave Sears, Managing Director and Asset Manager for the West Coast, said that the Strategic Property Fund is the firm's flagship fund and has a 6 to 9-month entry queue. Mr. Sears discussed the investment strategy of high quality, stable properties with dominant market positions in prime locations, the largest of which are in the western U.S. Mr. Sears considers demographics and job growth as important determinants for investments. Leverage is 25% which is asset-specific, he stated. Mr. Sears reviewed holdings by sector, with office representing the largest sector. Some advantages of the fund listed by Mr. Sears include continual upgrading of assets, the ability to pursue high-value assets without impairing diversification, and the resources to engage in off-market transactions as well as joint ventures.

Maintaining low leverage and continuing investment in the best available assets are the strategies going forward, according to Mr. Sears. Trustee Given asked how high value assets performed during the recent real estate downturn given their limited potential investor base, and Mr. Sears pointed out that higher value assets held value better than those of lower value.

d. 1:00 P.M. - UBS Realty Investors – Trumbull Property Fund

UBS Realty Investors Client and Portfolio Services Officer Deborah Ulian stated that the thirty-three year old core, open-end Trumbull Property Fund uses a team approach for investing in high-quality, well-leased assets in major metropolitan areas across the country. Regional asset management teams emphasize client service.

Assistant Portfolio Manager Stephen Olstein stated that the Trumbull Property Fund has a core strategy focusing on income, diversification, and low leverage. The Fund's size allows for pursuit of large deals. Properties are diversified by type, with the apartments the largest sector at 35%, and geographic region, with 39% of holdings in the East and 31% in the West. The Fund maintains leverage of 13% and their investment process and low leverage position enables them to access acquisition deals for properties with leverage already in place.

According to Mr. Olstein, in 2007 and 2008 the firm determined the market was unsustainable, ceased investing, and sold many assets before values began their decline. The firm focused on defensive strategies to increase rents and manage lease expirations. Currently, he stated, the firm is pursuing some value-added investments.

In summary, Mr. Olstein stated that discipline drives asset disposition, reduced fees for underperformance, and no internal adjustments for third-party appraisals.

Over ten years the fund outperformed the index by 1.4%, he said. The investment queue is expected to be four to six quarters.

Based on the presentations of the four core real estate candidates, Board members considered the relative merits of each fund and requested a review and assessment by Callan Associates. Ms. Angus observed that the UBS Fund has the most core characteristics and utilizes the least amount of leverage. Mr. Dunne provided comparisons of key attributes of the four funds, and Mr. Callahan compared yields with fixed income investments. Trustee Bolger discussed liquidity concerns regarding joint ventures and the ability to pay redemptions. Trustee Given distinguished the fund candidates by size and location of assets. Considerations encompassed sector diversification, investment fees, and investment queues. Based on discussions, Mr. Callahan advised that it would be reasonable to split the investment between two managers.

It was M/S Wofford/Gladstern to select UBS and Cornerstone as core real estate investment managers.

AYES: Brenk, Given, Gladstern, McFarland, Phillips, Webb, Wofford

NOES: Bolger

ABSTAIN: None

ABSENT: Haim, Richardson

Chair Phillips directed deliberations to **OLD BUSINESS, Agenda Item C.1.**

### **C. OLD BUSINESS**

#### **1. Investment Policy Update (Action)**

Mr. Wickman stated that Old Business updates to the Investment Policy Statement (IPS) reflect either prior Board actions or administrative revisions.

##### **a. Consider and take possible action on Amendment to Investment Policy Statement re: Eaton Vance Tax-Managed Emerging Markets Fund Statement of Objectives, Guidelines & Procedures (Action)**

Mr. Wickman advised that the Eaton Vance Statement of Objectives, Guidelines & Procedures is being added to the Investment Policy Statement.

It was M/S Webb/Given to approve the amendment to the Investment Policy Statement re: Eaton Vance Tax-Managed Emerging Markets Fund Statement of Objectives, Guidelines & Procedures. The motion was approved by unanimous vote.

##### **b. Consider and take possible action on Amendment to Investment Policy Statement re: State Street Global Advisors S&P 500 Flagship Non-Lending Fund Statement of Objectives, Guidelines & Procedures (Action)**

Mr. Dunne stated that the update reflects the Board's prior action to replace the BlackRock portfolio with the State Street Global Advisors S&P 500 Index.

It was M/S Gladstern/Webb to approve the amendment to the Investment Policy Statement re: State Street Global Advisors S&P 500 Flagship Non-Lending Fund Statement of Objectives, Guidelines & Procedures. The motion was approved by unanimous vote.

c. Consider and take possible action on Amendment to Investment Policy Statement re: Long-Term Strategic Asset Allocations and Ranges (Action)

Mr. Wickman stated that asset allocation revisions reflect the elimination of the market neutral program and other prior Board actions.

It was M/S Wofford/Gladstern to approve amendments to the Investment Policy Statement re: Long-Term Strategic Asset Allocations and Ranges. The motion was approved by unanimous vote.

d. Consider and take possible action on Amendment to Investment Policy Statement re: Placement Agent Payment Disclosure Policy (Action)

Mr. Wickman stated that the Placement Agent Payment Disclosure Policy is being replaced with the most recent version.

It was M/S McFarland/Wofford to approve amendment to the Investment Policy Statement re: Placement Agent Payment Disclosure Policy. The motion was approved by unanimous vote.

e. Consider and take possible action on Amendment to Investment Policy Statement re: Administrative Corrections (Action)

It was M/S Wofford/Gladstern to approve amendments to the Investment Policy Statement for administrative corrections. The motion was approved by unanimous vote.

f. Consider and take possible action on Amendment to Investment Policy Statement re: Short Term Investment/Cash Equivalents (Action)

Mr. Wickman stated that revisions reflect the elimination of non-relevant short-term investment reports.

It was M/S Webb/McFarland to approve amendment to the Investment Policy Statement regarding Short Term Investment/Cash Equivalents. The motion was approved by unanimous vote.

**NEW BUSINESS** continued.

2. S&P 500 High Yield Fund – State Street (Action)

Consider and take possible action to allocate funds to S&P 500 high yield fund

Chair Phillips said that the Board requested that Callan Associates present options for increasing yield within the passive S&P 500 allocation. Mr. Dunne reviewed characteristics of the current investment in the capitalization-weighted S&P 500 index. Other index options, according to Mr. Dunne, include those based on

Fundamental factors, equally weighted and dividend/yield orientated just to name a few Mr. Dunne discussed different index structures available within the Large Cap US Equity space. These may be distinguished as passive or active opportunity sets, according to Mr. Callahan; for example, index-based investment vehicles that skew investable items are active strategies in a rule-based structure.

The discussion focused on the array of index options available depending on goals regarding diversification, risk, and return. For example, Chair Phillips observed that using an index can provide for diversification and yield in addition to real estate and fixed income exposure. Mr. Callahan agreed and pointed to the value of a defensive position to reduce volatility in an uncertain capital market. For any index vehicle, its effect on the overall fund and its capitalization level versus the Russell 1000 should be measured, according to Mr. Callahan. Mr. Dunne observed that fundamentals-based indices are gaining interest in the public fund universe.

Chair Phillips recommended continuing discussions to the September Strategic Workshop when the Asset/Liability Study will be presented to the Board.

6. Ad Hoc System Risk Committee Report  
Consider and discuss initial system risk analysis

Ad Hoc System Risk Committee Chair Phillips stated that the Committee has reviewed system risk studies with SF Sentry for the quarter ending June 30, 2011. The studies view the total investment portfolio based on holdings and risk, according to Mr. Wickman. Several Trustees expressed an interest in reviewing and discussing the study results, which are to be presented at the Strategic Planning Workshop later in September.

7. Consider and take possible action on Amendment to Investment Policy Statement re: ING Clarion Statement of Objectives, Guidelines & Procedures to reflect ownership change to Clarion Partners (Action)

It was M/S Gladstern/Phillips to approve as submitted the amendment to the Investment Policy Statement ING Clarion Statement of Objectives, Guidelines & Procedures to reflect the ownership change to Clarion Partners. The motion was approved by unanimous vote.

8. Consider and take possible action on Amendment to Investment Policy Statement re: Dimensional Fund Advisors Statement of Objectives, Guidelines & Procedures to change benchmark to Russell 2000 Value Index (Action)

It was M/S Webb/McFarland to approve as submitted the amendment to the Investment Policy Statement Dimensional Fund Advisors Statement of Objectives, Guidelines & Procedures to change the benchmark to the Russell 2000 Value Index. The motion was approved by unanimous vote.



9. Consider and take possible action on Amendment to Investment Policy Statement re: Wellington Management Company Statement Of Objectives, Guidelines & Procedures (Action)

Mr. Dunne advised updating the Wellington and Western Statement of Objectives, Guidelines & Procedures with language regarding duration for consistency in total fund guidelines, and adding non-dollar items and bank loans to core plus sectors. Mr. Dunne stated that both fixed income managers have skills in these areas. Trustee Webb inquired about affecting the risk level, and Mr. Dunne and Mr. Callahan both indicated that the new items provide for additional diversification, and, as portfolio guidelines and quality limits still apply, are likely to mitigate risk.

It was M/S Webb/McFarland to approve as submitted and discussed amendments to the Investment Policy Statement Wellington Management Company Statement of Objectives, Guidelines & Procedures. The motion was approved by unanimous vote.

10. Consider and take possible action on Amendment to Investment Policy Statement re: Western Asset Management Statement of Objectives, Guidelines & Procedures (Action)

It was M/S Bolger/Gladstern to approve as submitted and discussed amendments to the Investment Policy Statement Western Asset Management Statement of Objectives, Guidelines & Procedures. The motion was approved by unanimous vote.

11. Investment Code of Conduct and Insider Trading Policy Review (Action)  
Conduct three-year Policy review

Chair Phillips deferred the matter for consideration at the next Investment Committee meeting.

There being no further business, Chair Phillips adjourned the meeting at 3:45 P.M.

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Jim Phillips, Chair

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Attest: Jeff Wickman  
Retirement Administrator