MINUTES

INVESTMENT COMMITTEE MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

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

January 12, 2012 – 9 A.M.

CALL TO ORDER Chair Richardson called the meeting to order at 9:03 A.M.

ROLL CALL PRESENT: Bolger, Brenk, Given, Gladstern, Haim, McFarland, Richardson, Webb (retiree alternate)

ABSENT: None

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.

Trustee Given joined the meeting at 9:05 A.M.

B. MANAGER ANNUAL REPORTS

1. Sector Overview – Fixed Income – Callan Associates

Investment Consultant Kevin Dunne of Callan Associates provided an overview of MCERA's fixed income portfolio. He stated that the role of fixed income, which represents approximately 26% of the MCERA portfolio, is capital preservation and diversification. Fixed income also reduces volatility, provides liquidity, and can serve as a hedge against deflation. Over time, the Plan's managers have achieved alpha against the Barclays' Aggregate benchmark. Periods of underperformance can be expected, he said, due to variations in interest rates, credit spreads and duration.

Trustee Bolger related that the system risk analysis pointed out the long duration of the holdings. Mr. Callahan referred the duration discussion to the investment managers. As to the fixed income allocation, the current risk-reward profile is appropriate, he explained, since the long-term assumption rate is higher than the fixed income yield. He reminded the Board that over time the typical allocation to fixed income has been reduced from 40% to the 25% range.

Mr. Dunne reminded the Board that the Wellington core fixed income portfolio would transition to the core plus strategy with discretion to seek alpha by selective investment in foreign debt and emerging market and high-yield securities. Chair

Richardson discussed a potential benchmark change with Mr. Dunne, who recommended retaining the Barclay's Aggregate since this benchmark remains more appropriate than Global benchmarks, while still allowing for manager discretion and potential outperformance by the investment managers.

As of September 30, 2011, the annual return for the fixed income portfolio was 5.84% (versus 5.26% for the Barclays' Aggregate), according to Mr. Dunne. Over the past seven years the return is close to the median. In response to Board Chair Gladstern's inquiry, Mr. Dunne attributed the Large Cap Domestic Equity program's periods of underperformance in part to the bondized market neutral program which has been eliminated.

2. <u>Wellington Capital Management</u>
Relationship Manager Sue Bonfeld reported that the portfolio is still managed by Campe Goodman. She reported that as of December 31, 2011, the portfolio's annual return was 7.94% gross of fees, slightly under the benchmark on a net basis. Over the past three years the portfolio returned 9.96% (versus 6.78% for the Barclays Aggregate), and over five years matched the benchmark return on a net basis.

The portfolio strategy, according to Ms. Bonfeld, utilizes bottom up analysis by sector specialists using proprietary research. Rotation is infrequent, she stated, and she reviewed portfolio positioning with regard to Treasurys, cash, mortgages, and credit. Mortgages were contributors to returns and duration and credit positions were negatives. Trustee Haim commented on the Treasury rally, and Ms. Bonfeld said that in spite of the credit downgrade in the summer of 2011, Treasurys continue to represent quality. Chair Richardson inquired about the timing of the underweight to Treasurys, which Ms. Bonfeld said is standard for the portfolio as credit spread assets are preferred.

In summary, Ms. Bonfeld said that the portfolio manager expects slowing growth around the world. Mr. Goodman is more positive for U.S. growth in 2012, she said, based on healthy corporate balance sheets.

3. <u>Western Asset Management</u>
Frances Coombes, Client Services representative for Western Asset Management, characterized 2011 as volatile due to paradigm shifts in fixed income. Events such as the U.S. Treasury downgrade and European sovereign debt credit issues have reduced liquidity, she said. For 2011 the portfolio returned 7.4%, below the benchmark by 0.5%, she reported. The portfolio manager is value oriented and sees value opportunities in high yield and bank loans.

Portfolio Manager Julien Scholnick expects a slow growth economic environment in 2012. He reported that portfolio returns were enhanced by duration positions and mortgage-backed securities, and negatively impacted by credit spreads, which have since been trimmed, he stated. He reported that Western's portfolio position is underweight to Treasurys, overweight to financials, and long duration as a global hedge as the yield curve flattens. Mr. Scholnick explained that the long duration position is highly liquid and therefore allows for a swift response to spread variations.

Mr. Scholnick discussed the technicalities of short positions with Trustee Haim and also addressed the trustee's query about potential headline risk. Trustee Bolger requested a discussion of the cash position, credit ratings, and the effect of the Federal Reserve's open posture regarding its intent for interest rates. Mr. Scholnick stated that cash is the result of trimmed positions. He attributed lower credit ratings to the market shift to non-investment grade status. As to Fed policy, transparency is helpful and he expects implications to become apparent over time.

C. <u>INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE</u>

For period ending September 30, 2011

Mr. Dunne reported that the markets declined in the third quarter of 2011. The Fund performed in the 80th percentile of the CAI Public Fund Sponsor Database, returning negative 10.58% (versus the negative 9.36% Composite Benchmark return). The markets have rebounded in the fourth quarter. The investment consultant reviewed target asset allocations relative to positions. The 12% real estate target allocation is higher than peers, and there has been discussion to consider diversifying the space, he said. Pegging the private equity target to actual until fully funded would be a reasonable decision to consider, according to Mr. Callahan.

Mr. Dunne reviewed domestic equity and private equity allocations versus the public fund universe, noting that the equity allocation drives returns. The Fund's higher equity allocation contributed to underperformance to peers, as equities have underperformed over the past 10 years, he said. Mr. Dunne observed that peers have diversified into hedge funds and infrastructure, rather than increase equities. Another peer trend, according to Mr. Callahan, is a move to a global footprint and lower volatility equities. The goal, he explained, is to achieve equity-like returns with reduced volatility.

Discussions about RCM performance led to general agreement with Mr. Callahan's recommendation to give the new select growth strategy time to perform. Callan Associates does not expect management structure changes at the firm to affect performance.

Trustee Given requested an analysis of passive versus active management returns in the large cap space. Mr. Callahan noted that over time he expects active managers to outperform as stock prices follow earnings. From inception to date, he reminded the Board, all managers have outperformed their benchmarks.

Mr. Dunne noted that the Dodge & Cox large cap equity portfolio has outperformed over 15 years. The microcap value Dimensional portfolio underperformance was balanced by the significant outperformance of the Columbus Circle small cap growth portfolio. International equity is outperforming with no changes recommended in the group.

D. OLD BUSINESS

E. NEW BUSINESS

1. Consider and take possible action on Amendment to Investment Policy Statement re: Appendix D, Update to Placement Agent Payment Disclosure Resolution and Policy (**Action**)

   Mr. Wickman stated that updates to the Investment Policy Statement reflect prior Board actions. This amendment updates Appendix D with the latest version of the Placement Agent Payment Disclosure Resolution and Policy.

It was M/S Given/Gladstern to adopt the amendment to the Investment Policy Statement to update Appendix D, Placement Agent Payment Disclosure Resolution and Policy, as submitted. The motion was approved by unanimous vote.

2. Foreign Currency Exchange Policy (**Action**)
   Consider and take possible action on Policy

   Based on discussions at the Finance and Risk Management Committee, Mr. Wickman presented proposed letter to the custodian and investment managers who deal with foreign currency transactions. Chair Richardson expressed approval and Trustee Gladstern said the drafts align with the due diligence process. Mr. Dunne stated that it would be reasonable to allow the managers to respond and to consider potential existing policies, and Mr. Wickman agreed to revise the letters accordingly.

   Trustee Bolger requested "best price" as well as "best execution" phrasing, since the two concepts are normally considered in trading practice. Trustee Bolger also asked to refer the issue of investment managers who do not acknowledge they are "fiduciaries to MCERA" to the Finance and Risk Management Committee for further analysis.

It was M/S Brenk/Given to approve foreign currency exchange letters to the custodian and international investment managers as amended per discussions. The motion was approved by unanimous vote.

Mr. Wickman informed the Investment Committee that Investment Counsel Pat Faulkner will retire in March.

Mr. Callahan reported that Mr. Dunne is resigning from Callan Associates. Mr. Callahan commended Mr. Dunne and said he will be missed at Callan Associates. The trustees expressed their appreciation to Mr. Dunne for his character and efforts on behalf of MCERA and wished him well.

There being no further business, Chair Richardson adjourned the meeting at 12:27 P.M.

Gerald Richardson, Chair

Attest: Jeff Wickman
Retirement Administrator