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

ROLL CALL  PRESENT: Bolger, Brenk, Cooper, Gladstern, Piombo (safety alternate), Richardson, Shaw (ex-officio alternate) (late), Stevens, Webb (retiree alternate)

ABSENT: Given, Haim, McFarland

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. MANAGER ANNUAL REPORTS
1. Sector Overview – Real Estate – Callan Associates
Callan Associates investment consultant Jim Callahan introduced associate Avery Robinson to present the real estate overview.

Trustee Shaw joined the meeting at 9:04 A.M.

Mr. Robinson reported that commercial real estate is rebounding while secondary markets continue to lag. Firms with strong balance sheets are taking advantage of low interest rates and leverage remains an issue for others. There is increasing interest in non-core investments. Multi-family assets led advances, with core unleveraged groups outperforming over the long term. Other signs of relative strength include declining vacancies across sectors, improved transaction volumes, compressed capitalization rates, and growing entry queues.

As of the year ending March 31, 2012, the real estate portfolio returned 13% (versus 13.41% for the composite benchmark). Real estate assets comprise 9% of the Fund with a target of 12%. Mr. Robinson compared sector weightings and geographic distributions to the benchmark. A discussion of key features of each real estate portfolio followed.
Funding for the Cornerstone Patriot Fund is underway. In response to Chair Richardson’s inquiry about the departure of President Mark Higgins, Mr. Robinson stated that with the addition of a Chief Operating Officer the Cornerstone management team is expected to remain strong. The UBS Trumbell Property Fund will be funded later next year. Both core funds have high occupancy rates and conservative strategies. The AEW and RREEF portfolios are in the liquidation phase. Greater than 80% of real estate investments are in the directly owned, unleveraged Woodmont portfolio.

In response to the inquiries of Trustees Bolger and Stevens regarding slowing appreciation rates, Mr. Robinson explained that the total expected long-term return from real estate is 6.8% with two-thirds to three-quarters derived from income and the remainder from appreciation. Mr. Callahan continues to support real estate as a viable diversifying asset with long-term appreciation potential.

2. AEW – Value added real estate – Dave McWhorter, Marc Davidson

Dave McWhorter, AEW Relationship Manager, stated that the value-added AEW Partners V Fund has performed in the top quartile of peers and is in the process of returning investor capital. He introduced Portfolio Manager Marc Davidson to present the portfolio review.

Mr. Davidson expressed confidence in the plan to return all investor capital by 2014. He stated that the current course of action is to sell into appreciating asset values. During the past year ten assets were sold with current properties selling at over carry value; for example, a hotel in Santa Cruz will bring returned capital to 60%.

The portfolio manager chose to close the fund in 2006 and stopped new investments in 2007 due to deteriorating market conditions. Capital reserves positioned the portfolio to recover from the subsequent downturn in the real estate market. Mr. Davidson characterized current conditions as closer to a trough environment that favors high-quality densely populated markets.

3. RREEF – Value added real estate – Laura Gaylord, Frank Garcia

Laura Gaylord, Head of Americas Client Relations for RREEF, reviewed management activities over the past year. In November 2011 Deutsche Bank conducted a strategic assets review and began negotiations with Guggenheim Partners regarding the sale of RREEF. Those negotiations ended in May 2012 without a sale the firm has decided to reorganize according to a long-term plan instead. The RREEF America III team remains stable after the retirement last November of CEO Tim Gonzalez. Ms. Gaylord introduced lead Portfolio Manager Frank Garcia to present the portfolio review.

Mr. Garcia stated that the current strategy is to stabilize the fund and proceed with an orderly liquidation of the remaining portfolio. In support of this effort, the independent Board is working to assure that sufficient resources flow from the controlling bank. Due to loan restructuring and asset sales, leverage has been reduced to 63%. Debt coming due in 2012 will be refinanced and the sale of residential assets will continue through 2016.
Chair Richardson inquired about a proposed plan to divide the fund which Mr. Garcia indicated is no longer being considered. The portfolio manager explained that after the credit facility is paid down investments will be returned on a prorata basis. Upon completion of the distribution process he expects 70 to 80% of capital to be returned to investors.

4. **Woodmont – Core real estate – Ron Granville, Bob Rouse, Scott Pritchett**

Ron Granville, Chairman of Woodmont Realty Advisors, stated that MCERA’s core real estate portfolio returned 12.9% on equity after fees for the year ending June 30, 2012. Cash flow represented 4.36% of the return and is projected to increase next year. The overall occupancy rate is 92%. There were significant capital improvements in the last year with appraised values rising over 7%, with the exception of Marina Bay. Office space represents the largest sector at 33% followed by a balance of flex space and multi-family, with a small portion dedicated to research and development (R&D).

Current market conditions include improved but still below normal transaction volume and fewer distressed property sales. Mr. Granville remarked that the coastal markets are the most favorable and San Francisco is a world-class market benefiting from the tech boom. Going forward he is “guardedly optimistic” subject to the effects of state and local deficits and the level of economic recovery.

Mr. Granville engaged in discussions with Trustees Bolger and Stevens about the importance of property fundamentals, the value of third-party appraisers, and opportunities in the apartment class. Mr. Granville stated that there will be no change in the conservative risk profile of the portfolio.

Chair Richardson recessed the meeting for a break at 10:25 A.M., reconvening at 10:35 A.M.

Trustee Brenk inquired about diversifying a portion of the Woodmont portfolio into other real estate funds. In response Mr. Callahan recommended retaining the allocation to Woodmont since it balances the risk of geographic concentration by not using leverage. He referred to the decision made several years ago to diversify into value-added vehicles that was negatively impacted by the real estate downturn.

Chair Richardson directed deliberations to **Agenda Items E.1 and E.2** for presentations on the securities lending program.

**E. NEW BUSINESS**

1. **Securities Lending Summary – Callan Associates, Jim Callahan**

Mr. Callahan presented a summary of securities lending based on the educational presentation given previously by Callan Associates consultant Bo Abesamis. Due to demand in the capital markets, securities are borrowed with cash provided as collateral. The cash is then invested by the lending agent during the loan. The question, he said, is whether to continue the securities lending program in view of the attendant risk. Trustee Bolger observed that the lending agent may take undue risk in pursuing returns.
2. **State Street Securities Lending Program Presentation (Action)**

Presentation and review of securities lending program

State Street Client Relations Manager Henry Disano reported that the securities lending program generated $465,000 in revenue for the Fund over the past fiscal year and $2.6 million since inception in 2007. He introduced Account Manager Jeffrey Trencher and Head of North American Cash Management Tom Motley for the presentation on the securities lending program.

Mr. Trencher reviewed the history of the liquidity and duration pools. New restrictions on money market funds require 30% of assets to mature within seven days, a maximum weighted average life of 120 days, and maximum maturity of 13 months, according to Mr. Motley. The duration pool was frozen in 2010 and is being wound down. Trustee Bolger pointed out the duration pool has an 8% unrealized loss which was attributed primarily to Australian and U.K. securities. Mr. Motley stated that the majority of asset-backed securities had been sold and non-performing investments were being monitored. Mr. Callahan pointed out that the difference in return between the duration and liquidity pools is approximately 10 basis points.

According to Mr. Trencher, risk factors include the European debt situation, the downgrade of financial institutions by Moody’s a few weeks ago, and tighter capital levels for banks. He expressed concern that European Central Bank (ECB) regulations reducing interest and deposit rates may result in either the refusal of banks to accept deposits, or charging fees to do so. He cautioned that the fact that major U.S. banks have ceased investment in European money markets is a serious matter.

In summary, State Street representatives stated that significant resources, including teams for credit and risk management, are dedicated to the securities lending program. They pointed out the advantage of incremental revenue in a low-interest-rate environment, the conservative investment approach, and adaptability of the program to new guidelines.

Mr. Wickman recommended retaining the securities lending program in view of new operating guidelines for the Quality D duration pool and the improved visibility and diligence of the program. Mr. Callahan and Trustees Webb and Shaw recommended continuing with the program as it is generating income for the Fund. In response to Trustee Stevens’ inquiry about the lack of proxy voting rights for securities on loan, Mr. Disano stated that the option to recall securities is available.

Trustee Bolger was not in favor of continuing the securities lending program due to cash management risk and the recommendation of Bo Abesamis to have a larger asset base. Mr. Callahan responded that State Street Global Advisors manages the cash and is a well-respected investment manager.

Chair Richardson recommended retaining and monitoring the securities lending program. In response to Trustee Bolger’s request, Mr. Wickman stated that State
Street would provide an annual review and information on securities lending would be reviewed by the Finance and Risk Management Committee.

Chair Richardson recessed the meeting for lunch at 12:30 P.M., reconvening at 12:46 P.M. and directing deliberations to Agenda Item C.

C. **INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE**
For period ending March 31, 2012

Callan Associates investment consultant Anne Heaphy presented the quarterly review and performance update. She reported that a first quarter rally turned to weakness as disappointing GDP and employment numbers lead to a flight to U.S. Treasurys in the second quarter. Declines continued in May following downgrades of Italian and Spanish banks. Subsequently in June the equity market (as represented by the S&P 500) staged its strongest single-month rally since 1999. For the remainder of the year volatility is expected to continue due in part to the unresolved European debt crisis and slowing growth here at home. For the first quarter of 2012 the Fund returned 9.13% (versus 8.24% for the composite benchmark), and 5.52% (versus 5.43% for the composite benchmark) for the prior 12 months.

During the second quarter fixed income assets advanced while equities declined. Ms. Heaphy reviewed the performance of sectors and individual portfolios. Notably, the international group outperformed the benchmark, with Artisan and Morgan Stanley providing downside protection.

Callan Associates will be conducting onsite due diligence meetings with Dodge & Cox and RCM over the next several weeks. Mr. Wickman recommended a review of RCM’s continued performance issues at the September Investment Committee meeting. Mr. Callahan noted that active large cap managers have had difficulty outperforming since 2008 given the European debt crisis, low-quality market rallies, and the larger relative weight of Apple stock in benchmarks.

D. **OLD BUSINESS**
None

Trustee Cooper was excused from the meeting at 1:10 P.M.

Chair Richardson directed deliberations to NEW BUSINESS, Agenda Item E.5.

5. **Rating Agency Adjustment of Financial Institutions**
Consider and discuss Moody’s downgrade of financial institutions

Callan Associates investment consultant Uvan Tseng reported that Moody’s followed other rating agencies by downgrading a number of financial institutions in June. He indicated there was minimal impact since the move was previously telegraphed to the markets. In the Investment Policy Statement, quality ratings are relative to the benchmark, according to Mr. Callahan.
Chair Richardson directed deliberations to **NEW BUSINESS, Agenda Item E.3.**

3. **Investment Management Process**  
Discuss historical approach to the current asset allocation and management of the portfolio

Mr. Callahan presented an overview of the investment management process as a framework for continuing discussions on potential changes to assets. Referencing discussions at the Spring and Fall Strategic Workshops, Mr. Callahan emphasized the importance of considering the investment process as a whole when determining the best course for prudent action.

The process of institutional investment management begins with an assessment of plan liabilities and return objectives to formulate asset/liability studies that define appropriate risk levels. The Investment Policy Statement articulates investment strategies and defines the role of each asset class. Once the program is implemented portfolios are monitored and evaluated over time.

Mr. Callahan proposed considering changes to the Board’s equity investments in light of expectations for a challenging capital markets environment over the next ten years. Both equity and bond holdings are subject to volatility due to a deleveraging cycle, he said, and as a result achieving target returns is unlikely. The current 62% equity allocation is high relative to peers and creates more volatility. Therefore, he stated, reducing volatility by diversifying without compromising returns is an appropriate strategy.

Trustee Piombo was excused from the meeting at 1:36 P.M.

In conclusion, Mr. Callahan advised looking at strategies to diversify the Fund.

4. **Alternative Investment Vehicles Presentation – Callan Associates, Jim Callahan**  
Presentation on absolute return investment vehicles such as covered calls, risk parity, and Global Tactical Asset Allocation (GTAA)

Mr. Callan directed proceedings to the Gateway Investment Advisers presentation on Covered Calls, **Agenda Item E.4.b.**

b. **Covered Calls – Gateway Investment Advisers**  
Harry Merrikan, PhD, Chief Investment Strategist and Principal of Gateway Investment Advisers, stated that new investment opportunities in the capital markets include covered calls that can enhance the risk-reward profile of investment funds. He explained that covered calls have lower risk than equities and are similar to fixed income securities, with cash flow generated from the time value of market volatility. This value is expressed in the premium for put and call options. In the case of covered calls, the call option is sold in return for the premium.
Data presented show that portfolios hedged with covered calls outperform the market in four of five scenarios. Market conditions favoring the covered call strategy include significant market selloffs, flat markets, high volatility, and low interest rates, according to the consultant. In these environments the collection of premiums cushions the downside and provides incremental revenue. Upside potential is trimmed in advancing markets.

Institutional investors use the CBOE S&P 500 BuyWrite Index, which he characterized as a true hybrid vehicle with higher returns than the bonds options index but lower than equities. Key advantages of using the index are high liquidity and settlement in cash.

In summary Mr. Merrikan defined the goal of using covered calls as focusing returns into a narrower band that is close to the target rate of return. Mr. Callahan discussed options strategies used by institutional investors with Mr. Merrikan and spoke to the twin goals of reducing equity risk and diversifying away from rising bond rates.

a. Risk Parity – AQR Capital Management
   Chair Richardson deferred the presentation on risk parity to a future meeting.

There being no further business, Chair Richardson adjourned the meeting at 2:43 P.M.

Gerald Richardson, Chair

Attest: Jeff Wickman
Retirement Administrator