CALL TO ORDER  Chair Richardson called the meeting to order at 9:10 A.M.

ROLL CALL  PRESENT: Bolger, Brenk, Given (late arrival), Gladstern, McFarland, Richardson, Shaw (ex officio alternate) (early departure), Smith, Stevens

ABSENT: Cooper, Piombo (alternate safety), Webb (alternate retiree)

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 – Callan Associates
   Discussion of private equity, including but not limited to J-curve effect and fees

Jim Callahan, Executive Vice President for Callan Associates, provided an overview of the private equity program. MCERA’s first private equity investments occurred in 2008 when the Board established an 8% total fund target allocation to private equity investments. He noted that private equity investments require a long-term commitment and are highly illiquid, with pricing occurring on a lagged quarterly basis. Mr. Callahan recommended vintage-year diversification with a consistent commitment to private equity over time as an appropriate course of action.

Current private equity portfolio managers, Abbott Capital Management and Pathway Capital Management, are fund-of-fund managers investing in limited partnerships with diversified holdings. Mr. Callahan noted that committed capital, which currently stands at 26%, has been impacted by the broader financial crisis. Across public funds, buyouts represent the largest category of limited partnership investing. Others include venture capital and special situations, which may be industry-specific and include subordinated and distressed debt.

Mr. Callahan stated that the program is emerging from the J-curve effect (when contributions exceed distributions due to fees paid on committed capital). Returns
will be more meaningful as the portfolios mature over time. According to a pacing analysis presented by Mr. Callahan, 2013 would be an appropriate time to consider new private equity commitments.

2. **Abbott Capital – Private Equity**

Jonathan Roth, Managing Director and President of Abbott Capital Management, and Charles van Horne, Managing Director, Marketing and Client Services, presented the Abbott Capital Private Equity (ACE) Fund VI annual review. Mr. Roth addressed the slow pace of investing committed capital, stating that it is necessary to leave the decision of when and where to invest to the fund managers.

Mr. van Horne reviewed the firm’s investment discipline that focuses on building high-conviction portfolios managed by skilled private equity managers. The ACE Fund VI is expected to be fully committed over the next six months, according to Mr. van Horne. The majority of holdings are U.S.-based and diversified among special situations, buyouts, and venture capital investments. In response to Trustee Stevens’ inquiry, Mr. Roth explained that the net asset value (NAV) is net of fees.

In summary, Mr. van Horne expressed confidence that the self-liquidating ACE Fund VI will achieve the expected returns over time. Trustee Bolger inquired about the impact of macroeconomic forces on the private equity industry. In response Mr. Roth stated the best managers will be able to generate returns under any scenario.

3. **Pathway Capital Management – Private Equity**

Jim Reinhardt, Senior Managing Director of Pathway Capital Management, presented the annual review of the Pathway Private Equity Fund 2008 (PPEF 2008). Mr. Reinhardt stated that consistent commitment to the best partnerships is the key to successful investing in private equity. Manager selection, as opposed to business sector or geographical region, drives investments, he said. The PPEF 2008 is 79% committed to underlying partnerships and is expected to be fully committed within a few months, according to Mr. Reinhardt.

Valerie Ruddick, Director of Pathway Capital Management, reviewed investment strategies, the largest of which are buyouts, followed by special situations, distressed debt, and venture capital. Geographically, 75% are U.S. companies with the remaining largely European. Over the past year the contribution pace has accelerated and is expected to continue, she said, as are distributions. Ms. Ruddick reviewed performance metrics across investment strategies and provided specific examples of internal rates of return for individual companies within each strategy.

Chair Richardson discussed the timing of a new fund which is expected to be available in the second quarter of 2013.
4. **Clifton – Futures Overlay**  
Jack Hansen, Clifton Group Principal and Chief Investment Officer, presented the annual review of the futures overlay program. The program objective is to increase total fund return by 10 to 20 basis points. Other objectives include lower policy-related investment performance risk, reduced risk during portfolio transitions, and increased daily access to liquidity.

Since the program was initiated, according to Mr. Hansen, cash flow management has become more efficient over time by reducing transaction costs and unwanted cash exposure. Positive returns are generated by securitizing residual cash through futures contracts on the S&P 500 Index, for example. Index contracts are widely traded, he explained, with returns that approximate the underlying index. Over the last year “mini-rebalancing” of overweight positions pushed the portfolio to allocation targets, according to Mr. Hansen.

In conclusion Mr. Hansen stated that futures may also be used to gain exposure to other asset classes such as commodities, for example.

Chair Richardson recessed the meeting for a working lunch at 12:30 P.M., reconvening at 12:45 P.M. and directing deliberations to **NEW BUSINESS, Agenda Item E.1**.

**E. NEW BUSINESS**

1. **Portfolio Rebalancing – Clifton, Jack Hansen**  
Educational presentation on portfolio rebalancing

Mr. Hansen stated that a fully implemented automatic rebalancing program would include the use of short positions and exposure thresholds. Allocations are contained within a target range by selling what has gone up and buying positions that have gone down. For example, a short position in the S&P 500 futures index would balance an overweight to equities. Under normal volatility suggested proportional bands would be plus or minus 5% to 10% of the target allocation.

Trustee Brenk inquired about taking advantage of market momentum prior to rebalancing. In response Mr. Hansen discussed the pros and cons of tighter or wider ranges in different market environments. Chair Richardson pointed out that ranges may vary across asset classes. The possibility of linking bands to risk metrics such as the value-at-risk (VaR) or the volatility index (VIX) was discussed by Trustee Brenk with Mr. Hansen.

In summary, Mr. Hansen presented projected return scenarios based on back testing that showed 12 basis points of added return with full rebalancing on a monthly basis using an average of 5% to 10% proportional bands. The incremental cost would be based on the level of rebalancing exposure. Mr. Hansen responded to trustee inquiries on the frequency of rebalancing and discussed potential vehicles such as TIPS futures and futures for commodities and global bonds.
Mr. Wickman and Mr. Callahan supported the full rebalancing program as a means of controlling risk by maintaining target asset allocations in an efficient manner. Chair Richardson advised considering the matter for action at the January Investment Committee meeting.

Trustee Given joined the meeting at 1:29 P.M. Trustee Shaw was excused from the meeting at 1:31 P.M.

Chair Richardson directed deliberations to Agenda Item F.2.

2. **System Risk Review – SF Sentry**
   Presentation and discussion of system risk analysis

   David Hansen of SF Sentry presented the September 30, 2012, quarterly system risk report. During the period equity markets rallied, cash levels were stable, and the volatility index declined with no material change to risk metrics. Observing that the VIX is considerably lower than in 2011, Mr. Hansen discussed the importance of the trend of the VIX as a market movement indicator. In response to Trustee Smith’s inquiry, Mr. White stated that the VIX is a useful tool in determining rebalancing bands.

   In his review of risk metrics, SF Sentry representative Scott White reported that fixed income managers are managing duration to keep interest rate risk in a reasonable range. Modeling results of a higher interest rate environment may be useful, he added. Low portfolio risk measures, according to Mr. White, reflect the rise in the equity markets in 2012. Mr. White noted the equity allocation is the driver of risk in the portfolio.

   Tim Holmes of SF Sentry reported on the increased correlation of international markets with U.S. markets. Mr. Holmes compared equity sector allocations to the S&P 500 and reviewed changes in top ten holdings which have increased in value to 7.2% of the portfolio. Mr. Holmes reviewed fixed income duration and credit quality and discussed the meaning of value-at-risk metrics in response to Trustee Smith’s inquiry. The fixed income portfolio is becoming more diversified, according to Mr. Holmes. Ms. Bolger commented on lower rated securities.

Chair Richardson directed deliberations to Agenda Item C.

C. **INVESTMENT CONSULTANT PERFORMANCE UPDATE**
   Update through September 30, 2012

   Mr. Callahan presented an update of portfolio performance through September 30, 2012, reporting that active portfolio managers have performed well during the period. Callan Associates will be monitoring the effect, if any, of Artisan’s initial public offering of 20% of the firm.

   The completed core real estate manager search resulted in three candidates for consideration at the January Investment Committee meeting: AEW, Invesco, and JP
Morgan. Discussions included the timing of transitioning funds from Cornerstone to a new manager and the management of transition funds by Clifton. When Trustee Given inquired about the performance of the current AEW investment, Mr. Callahan responded that AEW has a successful track record for core real estate investing. The current investment with AEW (an opportunistic strategy), he said, suffered due to market timing.

Chair Richardson requested an item be added to the January 2013 Investment Committee regarding future commitments to private equity. In response to Trustee McFarland’s inquiry, Mr. Callahan explained that the most important performance factor when selecting private equity funds is not size but the skill in identifying the best partners.

D. **OLD BUSINESS**
None.

**NEW BUSINESS, continued.**

3. **Transition of Large Cap Equity Assets (Action)**
Consider and take possible action on transition of RCM and Dodge & Cox assets to S&P 500 Index

Uvan Tseng, Vice President, Callan Associates Fund Sponsor Consulting, presented alternative passive large cap investment vehicles for the transition of funds from terminated active domestic large cap equity managers Dodge and Cox and RCM. Mr. Tseng reviewed the style exposure matrix in the domestic equity portfolio. After comparing domestic equity weightings to passive equity indices, Mr. Callahan recommended the S&P 500 Non-Lending Index Fund as the best option. Furthermore, he recommended allocating 30% in equal portions to domestic small cap managers Columbus Circle and Dimensional Fund Advisors, and the remaining 70% of the proceeds to S&P 500 Non-Lending Index Fund managed by State Street Global Advisors. The ratio of large cap to small cap domestic equities would be revised accordingly from 80/20 to 70/30.

It was M/S Gladstern/McFarland to reaffirm the termination of Dodge and Cox and RCM and invest the proceeds 30% in equal portions to small cap managers Columbus Circle and Dimensional Fund Advisors and 70% to the State Street Global Advisors S&P 500 Non-Lending Index Fund. The motion was approved by a vote of 7-1, with Trustee Smith opposed.

It was M/S Brenk/Stevens to rescind the prior vote in order to continue discussions. The motion was approved by a vote of 6-2, with Bolger and Given opposed.

Trustee Brenk expressed concern about increasing the target allocation to small cap equities. According to Mr. Callahan, the weighted average of the portfolio as a whole will be smaller than the benchmark Russell 3000 with the expectation that, over time, small caps outperform.

Trustee Gladstern reaffirmed her original motion as stated above. Trustee McFarland seconded, and the motion was approved by a vote of 7-0-1, with Trustee Smith abstaining.

4. **Investment Committee Charter (Action)**
Consider and take possible action on Governance Committee’s recommendation regarding updates to charter regarding participation of alternate trustees on the Investment Committee and meeting schedule

Mr. Wickman recommended tabling action and referring the Charter back to Governance for additional discussion and consideration.

Trustee Bolger was excused from the meeting at 3:30 P.M.

5. **Due Diligence Report – Eaton Vance**
   Report on on-site visit to Eaton Vance

On October 3, 2012, Mr. Wickman, Anne Heaphy of Callan Associates, and Trustees Gladstern and Bolger conducted an on-site due diligence meeting with Eaton Vance/Parametric at its Seattle offices. All in attendance were impressed by the knowledge and commitment of Chief Investment Officer David Stein. The structured emerging markets strategy centers on information technology with staffing depth in engineering and information technology fields. A report on fees including the 2% redemption fee, which benefits shareholders, was provided to Trustees Bolger and Gladstern. At the time the tax-managed fund was the less expensive option, according to Mr. Callahan, who indicated that it would take 20 years to recuperate the redemption fee given alternative vehicles’ cost structures.

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

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Gerald Richardson, Chair                      Attest:  Jeff Wickman
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Retirement Administrator