MINUTES

INVESTMENT COMMITTEE MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

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

January 9, 2014 – 9 A.M.

CALL TO ORDER Chair Brenk called the meeting to order at 9:06 A.M.

ROLL CALL PRESENT: Bartfeld, Bolger, Brenk, Given, Gladstern, McFarland, Piombo, Shaw (ex officio alternate), Shore, Smith, Webb (alternate retiree)

ABSENT: Cooper (alternate safety)

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. NEW BUSINESS

1. Intermediate Credit Investments – Western Asset Management (**Action**)
Presentation on intermediate credit strategy for fixed income investments

Jim Callahan, Callan Associates Executive Vice President, reviewed the structure of the domestic fixed income portfolio, noting that two managers have core plus strategies. Mr. Callahan proposed moving one manager, Western Asset Management, to an intermediate credit strategy for diversification and protection from potentially rising interest rates. The fixed income portfolio is being further diversified with the addition of global fixed income manager Colchester Global Investors.

Frances Coombs, Relationship Manager with Western Asset Management, stated that the firm has one of the largest credit-only research teams in the industry and generated top-quartile performance over the past five years. Ms. Coombs introduced Ryan Brist, Head of U.S. Investment Grade Credit and Portfolio Manager, for the presentation on the intermediate credit strategy.

Mr. Brist stated that the unconstrained intermediate credit strategy generates superior returns. Mr. Callahan further explained that the full-discretion mandate is appropriate in order to position the portfolio for the future after the long secular decline in interest rates. The expectation, he said, is to keep yield attractive while shortening duration.

Mr. Brist reviewed the investment management process combining top-down sector analysis with deep relative value analysis of company fundamentals and technical market conditions. Holdings are identified as core, under-valued, and opportunistic, prioritized in that order. Portfolio characteristics include an average credit quality of BBB/Baa2 and average duration of 4.2 years.

Mr. Brist reviewed the firm's risk management process that stresses the importance of avoiding losses. Risk management tools include a market and credit risk committee, strategy and portfolio reviews, dispersion analysis, counterparty risk exposures, and liquidity analysis.

Mr. Brist responded to inquiries from Trustee Bolger and Trustee Shore on the credit evaluation process and the effect of regulations, respectively. Mr. Callahan noted Western Asset performs its own credit evaluation, which he said is the point of having an active manager for the strategy.

In conclusion Mr. Brist views intermediate credit as the place to be in the next few years. Action on this matter is included under Item B.2 below.

2. <u>Implementation Plan for Fixed Income Assets (**Action**)</u>
Consider transition of assets for domestic and global fixed income portfolios

Mr. Callahan presented alternatives for implementing changes to the structure of the fixed income portfolio. The fixed income target allocation has been reduced to 23% from 26% of the Fund and the Board approved a 25% allocation to global fixed income. Mr. Callahan discussed guidelines proposed for the intermediate credit strategy and how holdings would differ from the current core plus model.

It was M/S Gladstern/Smith to approve moving the Western Asset Management fixed income portfolio strategy from core plus to the full discretion intermediate credit strategy.

Discussion included concerns expressed by Trustees Bolger and Shore with regard to moving to the intermediate credit strategy. Mr. Callahan provided further clarification as to why the intermediate credit strategy should be considered. Trustees Given, Gladstern, Piombo supported the intermediate credit strategy as a way of diversifying the portfolio. Trustee Piombo further noted that the strategy affords a higher expected return.

In summary, Mr. Callahan observed that moving to the intermediate credit strategy is reasonable given market conditions for the foreseeable future. The key questions, he stated, are whether to be concerned about rising interest rates and the need to reduce duration and move away from the concentration in U.S. government-backed credit.

AYES: Bartfeld, Brenk, Given, Gladstern, McFarland, Piombo, Shore, Smith

NOES: Bolger
ABSTAIN: None
ABSENT: None

Trustee Given was excused from the meeting at 11:03 A.M.

Chair Brenk recessed the meeting for a break at 11:04 A.M., reconvening at 11:27 A.M.

Mr. Callahan presented the implementation plan for fixed income assets that provides for three alternative allocations for the core plus, intermediate credit, and global fixed income strategies. As background Mr. Callahan presented performance measures for each strategy and explained the objective of moving fixed income holdings away from the mortgage-backed arena which has negative convexity exposure. The effect on overall duration based on various allocations was discussed.

It was M/S Piombo/Gladstern to adopt Alternative 2 with fixed income portfolio allocations of 50% to Wellington Core Plus, 25% to Western Asset Intermediate Credit, and 25% to Colchester global fixed income subject to the successful completion of contract negotiations.

Discussion included Trustees Bartfeld and Shore reference to Alternative 3 that allocates equal thirds to the three fixed income strategies.

AYES: Bolger, Brenk, Gladstern, McFarland, Piombo
NOES: Bartfeld, Shaw, Shore, Smith
ABSTAIN: None
ABSENT: Given

Trustee Webb was excused from the meeting at 12:05 P.M.

3. Analysis of Investment Manager Fees – Callan Associates
Review of investment manager fees as compared to the industry

Anne Heaphy, Vice President with Callan Associates, presented and reviewed the analysis of investment manager fees that compares fees paid by MCERA to the range of fees for particular style groups. Overall the report maintains that MCERA has favorable fee schedules with its managers.

Considerations include potentially moving international accounts to separate accounts for a 10-30 basis point savings (varies by account). Mr. Wickman discussed factors involved in opening accounts in separate countries. Other considerations include minimum account size and country allocations. Trustee Piombo observed that Artisan’s relatively high fees were not in line with performance. Based on discussions, Chair Brenk directed Administrator Wickman to develop a proposal with Callan Associates for moving Artisan and Morgan Stanley international portfolios to separate accounts.

Chair Brenk recessed the meeting for a working lunch, reconvening at 12:55 P.M.

Trustee Shaw was excused from the meeting at 12:55 P.M.

4. Due Diligence (**Action**)
   Consider and take possible action on investment manager due diligence site visit schedule for 2014

   Mr. Wickman presented a proposal for scheduling managers for due diligence site visits in 2014. As background the conditions set forth in the Trustee Due Diligence Policy for due diligence site visits of investment managers were reviewed that are based on a 3 or 5 year review cycle. Mr. Wickman noted that other peer systems perform due diligence site visits, some of which are annual.

   Chair Brenk recommended a team of two Board members, the Retirement Administrator, and a Callan Associates representative for due diligence trips.

Trustee Shaw rejoined the meeting at 1:04 P.M.

Trustee Piombo raised the question of whether trustee attendance added value to the due diligence onsite meetings when considering the relative expenses associated with having multiple attendees. Trustee Smith stated that it is in line with the Board's fiduciary responsibility to attend the due diligence onsite meetings. Trustee Gladstern recalled that historically trustees did not participate in site visits, but that other peer systems have trustees review managers on site. Trustee Bolger expressed her belief that it is the responsibility of the trustees to perform the due diligence visits.

Mr. Wickman explained that the trustees' responsibility to oversee managers as provided in the due diligence process cannot be delegated. Furthermore, he stated, information about managers has been obtained from the onsite visits he has participated in.

Based on discussions, Chair Brenk directed that the Governance Committee consider the Trustee Due Diligence Policy with respect to trustee participation in onsite due diligence visits at its next meeting.

It was M/S Bolger/Piombo to approve the investment manager due diligence site visit schedule for 2014 as presented.

AYES:	Bartfeld, Bolger, Brenk, Gladstern, McFarland, Piombo, Shaw, Shore, Smith
NOES:	None
ABSTAIN:	None
ABSENT:	Given

C. INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE

For period ending September 30, 2013

Ms. Heaphy presented the Callan Associates Quarterly Report as of September 30, 2013. She reported that U.S. equity markets rallied 6.4% during the quarter based on the Russell 3000 index. The MCERA Total Fund returned 5.44% net of fees (versus 5.55% for the Composite Benchmark) during the quarter ending September 30, 2013. Total assets for the end of the quarter stood just over $1.8 billion.

Ms. Heaphy reported on recent activity in the Fund, including an additional allocation to emerging markets and a capital call by AEW for the commitment to the Core Property Trust. Mr. Wickman detailed changes to the Fund's allocations that include commitments of $50 million to each of two core real estate managers in July 2013. For emerging markets, $35 million was added to the Eaton Vance portfolio through the collective investment trust vehicle. Additional commitments were made to private equity managers, and a portion of the fixed income portfolio was dedicated to global fixed income.

Performance characteristics of the Fund were reviewed by Ms. Heaphy. The allocation to domestic equity is overweight and is being used as a funding source. The MCERA Fund performance has improved significantly over the past five years, according to Ms. Heaphy. Asset classes contributing to outperformance were reviewed that include domestic equities, real estate, and fixed income.

Ms. Heaphy and Mr. Callahan responded to trustee comments and inquiries. With regard to private equity portfolios, Mr. Callahan explained that the managers are performing in line with their vintage year. According to Ms. Heaphy the group is out of the J-curve and up 10% over the past year. There have been more distributions from the Pathway fund due to its exposure to buyouts, according to Ms. Heaphy. In November, for example, MCERA received a $2.8 million distribution from Pathway, Mr. Wickman reported. Funding for follow-on commitments to the private equity managers is in process.

Trustee Shaw was excused from the meeting at 1:59 P.M.

Discussions included Trustee Smith's interest in analyzing the Fund's performance as compared with peer systems at a strategic planning workshop. Mr. Wickman pointed out that as systems are in different positions financially, direct comparison may be difficult to achieve. As an example, Mr. Callahan explained that liabilities will vary across systems, and the point is to meet the liability stream in a prudent manner rather than chase return.

There being no further business, Chair Brenk adjourned the meeting at 2:06 P.M.

Greg Brenk, Chair

Attest: Jeff Wickman
Retirement Administrator