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

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

ABSENT:  Smith

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
Annual review by investment consultant

Jay Kloepfer, Callan Associates Executive Vice President and head of capital markets research, presented the Capital Markets Review.  In introducing the presentation, Executive Vice President Jim Callahan noted that the report includes a liquidity analysis in the short and intermediate term originally developed with the 2011 Asset Liability Study.  Given the construct of the current portfolio, he said, Callan Associates has no concerns about cash flow.  This aligns with the cash flow study developed by MCERA staff and presented to the Board.

Mr. Kloepfer stated that capital markets projections are the cornerstone of long-term strategic planning, encompassing a broad scope of the macro and micro economic environment.  In this process short-term pressures must be balanced with the long-term view and conflicting goals and opinions considered.  The resulting capital market projections are tested and reviewed by Callan’s policy review committee.

Mr. Kloepfer discussed recent capital market activity including the relative outperformance of the United States economy in 2013 as non-U.S. markets lagged.  He noted also that interest rates are expected to rise in response to the tapering of bond purchases by the Federal Reserve (“Fed”).  According to Mr. Kloepfer, we are in an
unprecedented place in history with respect to monetary policy, the mishandling of which could lead to a stalled economy and potential disinflation. Geopolitical uncertainty would be a significant factor in shaping the future capital markets.

Capital market expectations for the next ten years were reviewed by Mr. Kloepfer. For fixed income, returns are expected to be 3%, up from 2.5%. Domestic equities are expected to hold at the previous projected return of 7.6%, with non-U.S. equities slightly higher at 7.8%. The equity return expectation is reasonably conservative, according to Mr. Kloepfer, who expects emerging markets to lead worldwide growth over the long term. The real estate return expectation is reduced slightly from 6.2% to 6.15% and hedge fund returns held at 5.1%. Mr. Kloepfer noted that MCERA’s private equity investments were still relatively new and advised patience as the expectation would be for higher returns over a longer period. The inflation expectation has been reduced from 2.5 to 2.25%. Mr. Kloepfer observed that equities are fairly valued based on historical price/earnings ratios.

Trustee Shore asked whether capital market projections have affected changes to the portfolio. As an example, Mr. Kloepfer pointed to the steady reduction in the fixed income allocation since 1998. Asset classes have also broadened to include emerging markets, real estate and private equity. In addition, Mr. Callahan stated, the Fund has been designed with an actively managed small cap bias that has paid off. Mr. Callahan noted that portfolio modifications have been gradual and reflect the changes in the structure of the Retirement Board.

Trustee Shore posed the idea that economic data can be noise. In response Mr. Callahan observed that the information flow is higher. In addition, the evolution in financial instruments has created more volatility in the markets which has to be dealt with, he said, while offering opportunities to capture returns in a disciplined approach.

In his analysis of economic metrics, Mr. Kloepfer observed that consumption, which makes up 70% of GDP, has been affected by high debt levels and the weak job market. These factors led to the relatively weak housing market and economic recovery since the financial crisis. In recent months job growth has picked up following a period of relatively low labor force participation. Given soft demand in a slow-growth environment with low capacity utilization, Mr. Kloepfer does not see inflation pressures.

In the international economy, an overhang from the sovereign debt crisis in Europe remains. Following weakness in emerging markets, many managers have reinvested as conditions are expected to be favorable over the long term.

Trustee Bolger inquired about debt levels in the U.S. In response Mr. Kloepfer noted that federal debt is contracting when compared to GDP. Since entitlements make up two-thirds of federal spending, he explained, reducing the federal debt is difficult.

Based on the capital market projections, portfolio returns expected over ten years were presented. Based on the current asset allocation, the portfolio ten-year return is projected to be approximately 7.1%. The projections do not include an active
management premium and are considered conservative for real estate and private equity. Over a longer period of 30 years, a higher nominal return is expected, according to Mr. Callahan. In response to Trustee Bolger’s inquiry, Mr. Callahan stated that MCERA’s real rate of return of 4.25% is considerably lower than Callan’s projected real return.

Probability ranges for achieving the 7.5% assumed rate of return were reviewed. In response to Trustee Bolger’s inquiry, Mr. Callahan and Mr. Kloepfer stated that there is a reasonable probability of achieving the return assumption over ten years. Chair Brenk inquired about the effect of lowering the return assumption, which Mr. Kloepfer stated would be to replace investment returns with employer contributions.

In conclusion, Mr. Wickman stated that the experience study conducted by the Actuary this summer will review MCERA’s economic assumptions for investment return, inflation and salary growth. The Actuary will provide recommendations to the Board for any changes in these areas and will review the Capital Market expectations as part of developing the recommendations. Mr. Callahan is comfortable with the target asset allocations and recommended funding up real estate to its target. Chair Brenk thanked Mr. Kloepfer for a good presentation.

Chair Brenk recessed the meeting for a break at 10:46 A.M., reconvening at 10:59 A.M. and directing deliberations to Agenda Item B.4.

4. Real Estate Reinvestment Alternatives
Preliminary discussion of reinvestment of private real estate portfolio proceeds

Mr. Callahan stated that the real estate portfolio, which is currently below its target of 15%, could be expanded to include other types of real assets. Mr. Callahan introduced Avery Robinson, Vice President and real estate specialist, for the presentation on reinvesting proceeds from the private real estate portfolio.

Mr. Robinson started by reminding the Committee that in March 2014 the decision was made to strategically sell off MCERA’s private real estate portfolio. Currently the AEW and UBS core open-end funds and the Woodmont separate account make up 97.6% of the real estate portfolio. The remainder is in mature value-added vehicles that are being wound down.

Mr. Robinson compared core and value-added strategies in response to Chair Brenk’s inquiry. According to Mr. Callahan diversification over vintage years is recommended for value-added vehicles that are typically closed end and employ higher leverage. As to Trustee Shore’s inquiry on the correlation between REITs and the AEW core fund, Mr. Robinson explained that REITs are affected by the equity markets. Mr. Callahan noted that privately owned real estate valuations tend to be less volatile than the daily market pricing of REITs.

Five options for reinvestment of proceeds from the sale of the private real estate were presented.
1. Reallocate the proceeds to the AEW and UBS core real estate funds in equal portions.

2. Add a third core manager which would provide some additional manager diversity.

3. Add new value-added strategies.

4. Add an open-ended core plus manager.

5. Invest in other real asset strategies.

Mr. Robinson provided an analysis of the advantages and disadvantages of each approach and discussed characteristics such as relative leverage levels, fees, and the types of investment vehicles available.

Trustee Brenk asked about the risk associated with higher leverage in the value-added strategy. Mr. Callahan stated that to minimize debt rollover risk, better managers diversify the debt structure over time. In response to Trustee Bolger’s inquiry on expected returns versus higher fees, Mr. Callahan stated it would be manager specific.

Possibilities for implementing the fifth option included expanding the real estate allocation to include other real assets such as REITS, commodities, agriculture or timber. As an alternative to relatively illiquid closed-end vehicles, a multi-strategy approach would use REITs, TIPs and commodities added to closed fund-of-fund vehicles. The closed-end funds would behave similarly to private equity funds with long-cycled cash flows and limited opportunities to invest. Another approach would be to use public REITs as a small component of the real estate portfolio for liquidity purposes, Mr. Callahan said.

Chair Brenk summarized the options presented and asked for trustee comments. Trustees Piombo and Gladstern expressed an interest in the value-added and core plus strategies for diversification and added return. As to the value-added approach, Trustee Given advised caution with respect to higher leverage, interest rate risk over time, and timing given the current real estate market. Chair Brenk observed that adding other real assets would give the most diversification. Setting aside the five options presented, Trustee Shore recommended investing in TIPs and small cap value equities. In Mr. Callahan’s view favoring TIPs would not be appropriate since the overall strategy has been to reduce exposure to the fixed income class and equities provide inflation protection over the long term.

Administrator Wickman, noting the complexity of implementing the strategy for other real assets, recommended narrowing down the options for further exploration. Trustee Bartfeld added that additional information on expected returns and cash flows would be of value. In response to Trustee Shore’s inquiry, Mr. Wickman explained that the purpose of increasing the real estate allocation to 15% was to diversify real estate given the high concentration of the Woodmont private real estate holdings. For perspective, Mr. Callahan advised keeping in mind the expectation for real estate when
considering strategies that are costly and complex. In addition, Mr. Callahan made a clear distinction between hedging risk as opposed to adding risk.

Trustee Given recommended staying with the current core real estate managers, noting that other real assets were considered in the past but not selected. Mr. Callahan stated that barriers to other real assets include complexity, cost and illiquidity, in addition to the difficulty of finding passive exposure. Trustee Webb supported staying with current core managers in view of geopolitical events in Iraq, for example, that may lead to a disruption in the oil supply.

Based on discussions, Chair Brenk concluded that there was consensus to direct the Administrator to implement Option 1 whereby proceeds from the private real estate portfolio and distributions from the maturing value-added funds will be invested in the AEW and UBS core funds. At the August 14 Investment Committee meeting plans for the transition of assets to the core real estate managers will be discussed further.

Chair Break recessed the meeting at 12:35 P.M. for lunch, reconvening at 12:56 P.M.

Chair Brenk directed deliberations to Agenda Item B.2.

2. Initial Future Cash Flow Analysis  
Consider and discuss cash flow analysis

Cash flow projections for one, three, five and ten years were presented by staff. In response to Trustee Webb’s inquiry, Mr. Wickman stated that cash flows from the Woodmont private real estate portfolio were factored into the analysis.

3. Structure of Morgan Stanley and Artisan Investments (Action)  
Consider and take possible action to move to separate accounts

Anne Heaphy, Vice President with Callan Associates, presented an analysis and comparison of investment fees in pooled versus separate accounts for the Morgan Stanley and Artisan international portfolios. Currently the accounts are in pooled vehicles that have higher investment fees than if the accounts were separately managed. Over a three year period, moving both portfolios to separate accounts is expected to result in savings of approximately $1 million, according to Ms. Heaphy.

In moving to separate accounts, expenses would include custodial fees that include fees based on market value and transaction fees, one-time transition costs, and startup fees to open accounts and register securities.

Ms. Heaphy presented a proposal for Callan Associates to manage the transition to separate accounts for $50,000. Upon discussion it was determined that the proposal would be considered separately.

It was M/S Given/Gladstern to move the Morgan Stanley and Artisan portfolios to separate accounts.
Discussions followed on Callan Associates proposal to assist with the transition to separate accounts. Mr. Wickman stated that there will be staff time in moving to separate accounts even with Callan Associates facilitating the transition. Opening accounts in separate countries involves the Administrator’s time, he explained.

Trustees Piombo and Bartfeld supported engaging Callan Associates to manage the transition as worth the expense. Based on the experience of Mr. Bartfeld, opening separate accounts can be a lengthy process. In response to Trustee Bolger’s inquiry, Mr. Callahan stated that Callan Associates has managed similar transitions although not directly at this level. Callan Associates’ Bo Abesamis and Mark Kinoshita are specialists in this area, he noted.

It was M/S McFarland/Webb to hire Callan Associates to assist with the transition of the Morgan Stanley and Artisan portfolios to separate accounts by entering into a new agreement for a fee not to exceed $50,000.

Trustee Given indicated that the value of having Callan Associates manage the transition to separate accounts remains unclear. In response Trustee Bartfeld discussed further details on the process of moving to separate accounts and referred to the expected savings.

Chair Brenk directed deliberations Agenda Item C.

C. **INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE**
   For period ending March 31, 2014

Ms. Heaphy presented the quarterly report and performance update. As of March 31, 2014 the total Fund net-of-fee return for the quarter was 1.29% (versus 1.77% for the composite benchmark) and for the past 12 months, 14.79% (versus 13.65% for the composite benchmark). Fund assets rose to $1.934 billion from $1.916 billion during the quarter. Ms. Heaphy reported that the Fund’s performance has improved relative to its benchmark over the intermediate timeframe and the track record now outpaces the index in all time periods.
During the first quarter of 2014 transitions in the fixed income portfolio include the move to the intermediate credit strategy for the Western Asset portfolio in February and funding of the Colchester global fixed income portfolio in March. In April the AEW core real estate portfolio was fully funded. The outstanding commitment to the UBS core real estate portfolio is expected to be called by the end of the calendar year. Funding of new commitments to private equity managers Abbott Capital Management and Pathway Capital Management is underway as capital is called.

Portfolio asset allocations are in line with interim targets, according to Ms. Heaphy, with a slight overweight in domestic equity. In equities Dimensional, Morgan Stanley, Artisan and Pyramis slightly underperformed benchmarks during the quarter. Attributors to performance included the overweight to domestic equity. The slightly negative manager effect (calculated net of fees) was discussed, with Mr. Callahan explaining that factors include stock selection and weighting relative to the index.

In reviewing performance particulars, Ms. Heaphy noted that a rotation in the equity markets from growth to value in April 2014 affected the performance of small cap growth manager Columbus Circle. The Eaton Vance structured emerging markets portfolio protected on the downside by generating positive returns against a negative index. The new Western Asset intermediate credit strategy has produced positive results.

In conclusion, Ms. Heaphy reported that fiscal year returns to date are well ahead of the 7.5% return assumption. A performance update through May 2014 was presented and reviewed. Reporting on management transitions, Ms. Heaphy stated that Wellington CEO Perry Traquina will retire on June 30, 2014, with current President Brendan Swords taking his place. At Colchester senior management changes were reported in the Operations and Compliance departments as a response to the increased regulatory environment.

There being no further business, Chair Brenk adjourned the meeting at 1:52 P.M.