

## MINUTES

### INVESTMENT COMMITTEE MEETING MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

One McInnis Parkway, 1<sup>st</sup> Floor  
Retirement Board Chambers  
San Rafael, CA

August 14, 2014 – 9 A.M.

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**CALL TO ORDER** Chair Brenk called the meeting to order at 9:02 A.M.

**ROLL CALL** PRESENT: Bartfeld, Bolger, Brenk, Given, Gladstern, McFarland, Piombo, Shaw (ex officio alternate), Shore, 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. MANAGER ANNUAL REPORTS**

1. Manager Overview – Callan Associates

Jim Callahan, Callan Associates Executive Vice President, introduced representatives of Morgan Stanley and Eaton Vance / Parametric for the annual portfolio reviews. In response to Trustee Bolger's inquiry Mr. Callahan noted that the Fund can have exposure to emerging market debt through its global fixed income portfolio managed by Colchester which invests in sovereign debt, and Western Asset through the intermediate credit strategy which can invest in a small amount of emerging market debt.

2. Morgan Stanley, International Equities – Nancy J. Norton – 9:05 A.M.

Nancy Norton, Senior Portfolio Specialist for international equities at Morgan Stanley, reviewed their international equity portfolio. Ms. Norton stated that the strategy is to invest in quality companies with high returns on capital deployed with the goals of preservation of capital and compounded returns over time. Key factors for investments are solid management teams, sustainable free cash flows, and the opportunity to invest at a discount to long-term strategic value.

Ms. Norton reported that portfolio manager Peter Wright, co-head of the international equity team, is retiring from the industry. As a result William Lock will become the

sole head of the team. Mr. Wright will remain through the calendar year to assure coverage by a senior team member of the telecommunications, materials and energy sectors he followed.

The portfolio returned 20.84% gross of fees (versus 23.57% for the MSCI EAFE Index) for the fiscal year ending June 30, 2014. Ms. Norton reviewed factors affecting performance relative to the benchmark such as an overweight to the consumer staples sector in the last half of 2013 that is since recovering. Other factors included an average 3% cash level and overweight to financials in Japan where markets retreated. Ms. Norton explained that fundamentals in Japan remain reasonable as attempts by Japanese policy makers to use fiscal, monetary and structural labor policies to boost the economy caused volatility in the stock market. In response to Trustee Shaw's inquiry, Ms. Norton explained that they are trying to inflate the economy and there were concerns that labor market reforms may be hard to implement. Ms. Norton addressed the relative outperformance of high beta regions such as Australia. Because of regulations the portfolio has no exposure to utilities that performed well.

Trustee Brenk asked about the economic exposure for the specific international investments. Mr. Callahan explained that with a global economy, developed market investments may derive a significant portion of income from emerging markets. Similarly, emerging market companies may derive their revenues from developed markets. Overall the Fund is globally diversified, he stated, and covers the global opportunity set to capture the capitalization of the emerging markets.

In conclusion, Ms. Norton stated that the outlook and strategy at this time is that quality companies and the consumer staples sector are expected to outperform with relatively strong earnings growth. Trustee Shore inquired about performance in the last decade. In response Ms. Norton reviewed three-year rolling returns since the inception of the portfolio that show the portfolio provides downside protection by outperforming in falling markets. This is a key element of the investment strategy that is one reason the firm is able to retain clients, she said. Trustee Bolger inquired as to whether environmental, social or governance factors were considered. In response Ms. Norton stated that governance is very important to make sure that companies are run for the benefit of shareholders. Ms. Norton pointed out that there is exposure to natural gas because it is cleaner than coal and engines for hybrid powered cars that burn fuel efficiently.

Chair Brenk recessed the meeting for a break at 9:50 A.M., reconvening at 9:55 A.M.

3. Eaton Vance / Parametric, Emerging Markets – Dan Ryan, Brian Dillon, Kristen Gaspar – 9:50 A.M

Kristen Gaspar, Senior Relationship Manager with Eaton Vance, introduced Dan Ryan, Director of Client Relationship Management for Parametric Portfolio Associates, who is taking over the relationship moving forward. As of June 30, 2014 all reporting has transitioned to Parametric, according to Ms. Gaspar. In response to Trustee Bolger's inquiry, Mr. Ryan stated that Parametric is building out its legal and compliance resources and also utilizes Eaton Vance resources.

Mr. Ryan stated that the emerging markets equity portfolio provides for consistent performance through a disciplined, systematic alpha approach. Mr. Ryan introduced Institutional Portfolio Manager Brian Dillon who presented the portfolio review. MCERA is invested in two emerging market vehicles that returned 17.38% (versus 14.68% for the MSCI Emerging Markets Index) as of June 30, 2014.

Mr. Dillon stated that the portfolio management strategy provides for active diversification away from concentration risk that results from a passive approach. Mr. Dillon further stated that a premium is extracted from the market by exploiting volatility through rebalancing. The result is significant outperformance with downside protection and relatively lower volatility. Country selection and rebalancing are responsible for 85% of outperformance, he said.

Responding to Trustee Shore's inquiry, Mr. Dillon explained that the allocation to China was reduced because it exceeded the 35% risk metric. In response to Chair Brenk's inquiry, Mr. Dillon explained that when conditions change in individual countries, market cap and liquidity are key decision factors. Mr. Dillon explained how factors such as standard deviations and relatively low correlations across emerging market countries are used to smooth risk over a larger subset of countries. The function of frontier markets, he said, is to lend broad diversification. Trustee Webb inquired about the conditions of political unrest in the Ukraine. Noting that the portfolio has very minor exposure to the Ukraine, Mr. Dillon explained that the strategy focuses on the dispassionate pursuit of long-term diversified exposure across market cycles and changing opinions.

In conclusion, Mr. Dillon used the term "systematic alpha" to describe the investment strategy. In response to Chair Brenk's inquiry, Mr. Dillon discussed the difficulty of restricting investments according to an environmental-social-governance (ESG) model in pooled vehicles. A portfolio customized to restrict a particular industry would lag if the restricted industry outperformed the market, according to Mr. Dillon.

Chair Brenk recessed the meeting for a break at 10:47 A.M., reconvening at 11:05 A.M.

**C. NEW BUSINESS**

**1. Plan for Real Estate Transition**  
Report on transition of assets

Chair Brenk stated that the disposition and transition of assets from the Woodmont private real estate portfolio is being presented for further discussion. At the June 12 Investment Committee meeting the Committee selected the first of five options for reinvesting proceeds, which is to invest equal portions in the core real estate managers AEW and UBS. Trustee Given has indicated the timing of reinvesting proceeds should be considered with respect to interest rates.

Trustee Piombo recommended an educational session on other real assets at the October workshop. Mr. Callahan reviewed the five options for reinvesting proceeds, ranging from current core real estate managers to value added strategies and other real

assets, in response to Trustee Bolger's inquiry. Mr. Callahan explained that the benefits of the core real estate strategy include a lower risk/return profile with returns driven by income from seasoned properties, thus muting real estate market cycles. Other options include a core plus strategy that has higher leverage and a value-added component.

Mr. Wickman and Mr. Callahan supported Chair Brenk's recommendation to schedule an educational session on selected real estate and real asset investments at the October workshop. Commitments to the two core real estate managers can be made, according to Mr. Wickman, and then withdrawn if needed without repercussion during the period before and up to when capital is called. Trustee Given expressed his interest in hearing from AEW and UBS on the current real estate market.

It was M/S Piombo/McFarland to commit \$50 million each to the AEW and UBS core real estate managers.

Chair Brenk directed the Administrator to schedule educational sessions at the October workshop on real estate and alternative real assets. Sessions with AEW and UBS will be scheduled for the Investment Committee.

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

#### **D. INVESTMENT CONSULTANT PERFORMANCE UPDATE**

Mr. Callahan reported that the Fund returned 18.07% net of fees in preliminary results for the fiscal year ending June 30, 2014. Mr. Callahan introduced Anne Heaphy, Vice President of Callan Associates, for the performance update. Ms. Heaphy reported that the Fund's preliminary value is just shy of \$2 billion as of June 30, 2014. The final return for that period will include updated real estate and private equity values that will be provided in the quarterly report to be presented at the September Investment Committee meeting.

Ms. Heaphy stated that equities rallied during the quarter ending June 30, 2014, with the large cap index fund up 5.25%. There was profit-taking in the small cap sector and value outperformed growth. In international portfolios Morgan Stanley outperformed the MSCI EAFE Index and Artisan rebounded from underperformance in the first quarter due to relative strength in the consumer staples and emerging markets sectors. Pyramis slightly underperformed the S&P EPAC Small Cap Index due in part to stock selection in Japan. All three fixed income portfolios – Colchester, Wellington, and Western Asset – outperformed their indices. A performance update through July 31, 2014 was provided by Ms. Heaphy showing the markets retreating due to current macroeconomic themes of slowing economic growth and geopolitical concerns.

Chair Brenk inquired about the Fund's return as compared with the San Diego County Employees' Retirement Association (SDCERA). In response Mr. Callahan explained that

the Fund's relative outperformance to peers is a result of other systems reducing public equity exposure to move into other assets or strategies. In response to Trustee Given's inquiry, Mr. Wickman discussed the investment management structure at SDCERA. Mr. Callahan observed that Fund performance relative to peers will vary and he emphasized the importance of having a strategy and sticking with it through different boards.

There being no further business, Chair Brenk adjourned the meeting at 12:15 P.M.

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Greg Brenk, Chair

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Attest: Jeff Wickman  
Retirement Administrator