MINUTES

INVESTMENT COMMITTEE MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

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

June 11, 2015 – 9 a.m.

CALL TO ORDER Chair Brenk called the meeting to order at 9:04 a.m.

ROLL CALL PRESENT: Bartfeld, Bolger, Brenk, Given, Haim (alternate retiree), Shaw (ex officio alternate), Shore, Thomas, Webb

ABSENT: Cooper (alternate safety), Piombo

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 – *Jim Callahan, Callan Associates*

   Jim Callahan, Callan Associates Executive Vice President, noted that moving Morgan Stanley to a separate account will be discussed later in the meeting under Agenda Item C.1. Chair Brenk referenced public interest in environmental, social, and governance (ESG) issues regarding climate change and requested that reporting managers address the topic.

2. Morgan Stanley, International Value Equity – *Nancy Jean Norton – 9:05 a.m.*

   Nancy Jean Norton, Morgan Stanley Executive Director, reviewed prepared remarks from the investment team on climate change. The team acknowledges the potential risk to investment performance of environmental factors such as climate change. Investments are selected according to a fundamental bottom-up analysis with a focus on long-term sustainability of each company's return on capital. Assessing the impact of the fossil-fuel-based emission of carbon dioxide on climate change is complicated and gives rise to numerous considerations. These include assigning culpability and determining whether there is a causal link between carbon emissions and climate change.

   The effect of regulation on utilities and the automobile industry to reduce carbon emissions is likely to suppress profits. As a result of changing market conditions the team looks to capitalize on opportunities such as the increasing demand for alternative energy. The investment team discusses risks deemed significant with company management and employs a risk/reward analysis to assess threats to return on capital and the long-term sustainability of returns.

In response to Trustee Shore's inquiry on governance, Ms. Norton stated that the firm eliminated proprietary trading and examined compensation structures in response to fines imposed on the banking industry following the financial crisis. There is extensive engagement with companies on governance matters such as executive compensation and incentive models with respect to long-term investment performance. According to Ms. Norton, Morgan Stanley is well positioned to create sustainable business models that strengthen communities and sustain environmental resources.

Ms. Norton noted that during 2014 the strategy slightly underperformed its benchmark in a down market for the first time in its history (negative 1.27% versus negative 0.92% for the MSCI EAFE Index). This was a result of a fourth quarter event predominantly due to the decline in the price of oil. She attributed underperformance to the fact that oil majors, which are not held in the Morgan Stanley portfolio, performed relatively well. Other companies were discussed by Ms. Norton that will be retained in the portfolio through price declines because of the expectation for long-term compounding of return on capital. In the quarter ending March 31, 2015, the portfolio returned 5.06% versus 4.88% for the benchmark.

In summary, Ms. Norton noted that return on invested capital is significantly higher for the portfolio relative to its benchmark. She pointed to metrics including sustained cash flows indicating that eventually the portfolio will provide a steady return on capital and protection in down markets. Due to current market conditions the strategy is neutral and turnover is low.

3. <u>Dimensional Fund Advisors, Small Cap Value Equity – *Ted Simpson, John Law – 9:30 a.m.*</u>

Ted Simpson, Dimensional Fund Advisors Vice President, stated that the U.S. Small Cap Value Trust portfolio shows strong outperformance during the past year and over the long term. For the quarter ending March 31, 2015 the portfolio returned 2.46% net of fees (versus 1.98 for the Russell 2000 Value Index). As to Chair Brenk's inquiry on how an ESG-biased portfolio would perform, Mr. Simpson stated there is considerable data but no consensus. Because of the power of diversification, he explained, returns would not be expected to be enhanced by eliminating holdings due to ESG concerns.

Mr. Simpson stated that the goal of the strategy is to outperform the benchmark by employing broad diversification based on empirical studies of sector return patterns. There is a strong focus on efficient implementation whereby trading costs are minimized by using pricing opportunities created by market moves and characteristics. Mr. Simpson introduced Portfolio Manager John Law to present the portfolio review.

Mr. Law stated that the strategy captures premiums from the market based on research on the performance of different types of stocks over the long term. As stocks move out of the small cap category, he said, they are held longer to capture upward momentum. During 2014 small cap stocks experienced a headwind, he said, attributing the portfolio's outperformance to trading efficiencies and capturing price momentum. Traders pay close attention to the best price environment to trade and delay selling stocks exhibiting positive price momentum.

In conclusion Mr. Law stated that five-year moving average returns reflect consistent returns and the portfolio strategy adds value with no style drift or surprises. In response to Trustee Bolger's inquiry, Mr. Law explained that small cap stocks are more volatile but allow for higher returns with a highly diversified portfolio. Emerging markets funds are generally more volatile than a domestic small cap portfolio, he said.

Chair Brenk recessed the meeting for a break at 10:05 a.m., reconvening at 10:16 a.m.

4. Pyramis Global Advisors, Small Cap International Equity – *Art Greenwood, Nick Horn – 9:55 a.m.*

Art Greenwood, Pyramis Global Advisors Senior Vice President and Relationship Manager, stated he is returning to service the MCERA account. Mr. Greenwood reported that the strategy is a fundamental bottom-up approach that has met the goal of adding 300 basis points (gross of fees) to the benchmark return. For the quarter ending March 31, 2015 the portfolio returned 6.29% net of fees (versus 5.49% for the S&P EPAC SC Index Net). Regarding ESG matters, he said, many of the associated risks are contemplated and reviewed by analysts when assessing sectors and companies. The portfolio vehicle is an international small cap commingled pool. Mr. Greenwood introduced Institutional Portfolio Manager Nick Horn to present the portfolio review.

Mr. Horn stated that the objective of the strategy is to exploit the inefficiencies of the small cap asset class. The research platform supported by local analysts is used to determine stock selections. The strategy is region and sector neutral and results in a relatively low tracking error that consistently adds value in a variety of market environments, he stated. In discussing characteristics of different sectors, Mr. Horn noted increased merger and acquisition activity in the health care sector.

Mr. Horn stated the portfolio performed well in the fourth quarter of 2014 and the first quarter of 2015 showing the quality bias. Mr. Horn reviewed performance across regions and sectors, noting small caps are recovering since March of this year from underperformance in 2014. In discussing attribution, Mr. Horn pointed to relative strength in the consumer staples sector in Asia and discussed a few successful companies in that space.

Responding to trustee inquiries, Mr. Horn stated there are ample buy ideas to replace sold positions. Analysts assess whether macro risks related to political events outweigh the value of a particular sector or security. Mr. Horn noted that analysts have raised concerns about the difficulty of assessing the value of assets in China. On-site visits are used to determine whether companies have adequate cash flows, real products and good management teams. In response to Trustee Webb's inquiry, Mr. Horn stated that exposure to German financials is small and the portfolio is underweight the European periphery which includes Greece.

In conclusion with respect to the climate change issue Mr. Horn stated that economic risk is low in the 2% of the portfolio in the energy sector since holdings tend to be refiners, not the companies with resources in the ground.

C. OLD BUSINESS

1. Structure of Morgan Stanley and Artisan Investments
   Consider and discuss process for moving to separate accounts

   Mr. Wickman referenced previous discussions by the Investment Committee regarding moving the Artisan and Morgan Stanley international accounts to separate accounts to save on fees. The Administrator discussed his experience with the complexities of opening custodial accounts in other countries. Mr. Wickman requested direction from the committee with respect to pursuing separate accounts for the pooled international portfolios.

   Committee members considered the Administrator's priorities and whether to wait for the Chief Financial Officer to move to separate accounts.

Trustee Given was excused from the meeting at 10:48 a.m.

Responding to Trustee Bolger's inquiry, Mr. Wickman explained the custodian is already established and it is a matter of a lot of work to get custodial accounts in the needed countries. Most accounts would need to be established, according to Mr. Callahan, before transitioning the accounts. Trustee Bolger indicated her preference to move forward to save money on fees. Chair Brenk, Trustee Shore and Mr. Callahan supported her view and the Chair directed the Administrator to proceed with moving the Artisan and Morgan Stanley portfolios to separate accounts.

D. NEW BUSINESS

1. BlackRock US Treasury Inflation-Protected Securities (TIPS) Fund (**Action**)
   Review and discuss the structure of the new BlackRock TIPS fund, specifically whether the fund will provide lending.

   Mr. Wickman noted that the Board has already made the decision to hire BlackRock as its manager for US Treasury Inflation-Protected Securities (TIPS). The question at hand is whether to utilize the lending or non-lending BlackRock TIPS vehicle. Mr. Callahan explained that the lending vehicle has the lowest fee and revenues from securities lending more than cover investment fees. Mr. Callahan stated that BlackRock's heritage is in risk management and high-quality short-term investing.

   In response to Chair Brenk's inquiry, Mr. Callahan stated that the lending vehicle outperforms the non-lending vehicle by 10 basis points per year. Trustee Bolger observed there are more assets in the non-lending vehicle, which Mr. Callahan attributed to a general move away from securities lending. The reason is that during the financial crisis the liquidity of cash collateral pools became challenged. Since then regulation has constrained investment options and the investment consultant believes there would be small likelihood of collateral asset impairment in the BlackRock securities lending vehicle. Responding to Trustee Bolger's inquiry, Mr. Callahan indicated that, along with other financial institutions, BlackRock experienced liquidity issues during the financial crisis but has a strong heritage as a risk specialist.

In summary Mr. Callahan characterized the lending vehicle as an interesting and attractive investment due to its increased return, fee savings, and the current use of securities lending in the Fund.

It was M/S Shore/Webb to select the securities lending version of the BlackRock US Treasury Inflation-Protected Securities (TIPS) Fund.

Mr. Callahan explained in response to Trustee Thomas' inquiry that borrowers use securities to enter short positions and settle trades due to timing issues. Responding to Chair Brenk's inquiry, Mr. Callahan said the TIPs vehicle has no impact on the analysis to allocate funds to real assets because the return assumption was based on the TIPs index.

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

2. Investment Policy Statement Updates (**Action**)
Consider and take possible action on recommended amendments to Investment Policy Statement re:

Mr. Wickman explained that revisions to the Investment Policy Statement memorialize decisions already made on the real assets allocation. There is one exception which is to provide for the use of preferred securities in the Wellington core plus fixed income portfolio, similar to the guidelines for the Western Asset intermediate credit fixed income portfolio.

It was M/S Shore/Webb to adopt amendments to the Investment Policy Statement listed in Agenda Items D.2.a-g below as presented.

a. General Investment Objectives and Guidelines, to add benchmarks for Real Assets Portfolio

b. Appendix A, Long-Term Strategic Asset Allocation Targets and Ranges, to add Real Asset Classes

c. Appendix B-8, Wellington Management Company Core Plus Fixed Income Statement of Objectives, Guidelines & Procedures, regarding asset allocation

d. Appendix B-11, BlackRock US Treasury Inflation Protected Securities Fund

Statement of Objectives, Guidelines & Procedures

e. Appendix B-12, BlackRock Commodity Index Fund Statement of Objectives, Guidelines & Procedures

f. Appendix B-13, State Street Global Advisors S&P Global LargeMidCap Natural Resources Index Fund, Statement of Objectives, Guidelines & Procedures

g. Appendix B-14, Vanguard REIT Index Fund, Statement of Objectives, Guidelines & Procedures

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

E. INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE

For period ending March 31, 2015

Mr. Wickman discussed plans to schedule a future educational session on potential proactive investment opportunities with respect to environmental, social and governance (ESG) topics. Based on the Administrator's consultation with Mr. Callahan together with Investment Committee Chair Brenk, Mr. Callahan will develop the presentation. Chair Brenk said it makes sense to have a broader discussion on the ESG topic.

Mr. Callahan stated that Callan Associates has a task force on the topic with surveys and research to bring forward. In addition Mr. Callahan will consider outside sources who may bring added value and balance to the discussion. In Mr. Callahan's view the investment management community mindset follows Morgan Stanley's thesis that the companies they invest in will add value. The idea of divesting is problematic from a fiduciary standpoint, he said. The investment consultant stated that what may have the most merit is to consider proactively investing in a thesis that capitalizes on the climate change matter to look at where the future is headed for energy. There is mixed evidence on relative returns for environmental or social matters, he said, and confirmed evidence that good governance leads to better returns.

Trustee Haim referenced a bill in the California legislature regarding fossil fuels and encouraged a response to the public dialogue questioning the quality of the Fund's related investments. In response Chair Brenk indicated that our investment managers are taking these things into consideration and furthermore we are asking Callan Associates to consider potential approaches.

Mr. Wickman explained that the SB185, passed by the California Senate, would require CalPERS and CalSTRS to divest from "Thermal Coal Companies." The bill also states "Nothing in this article shall require a board to take action as described in this section unless the board determines, in good faith, that the action described in this section is consistent with the fiduciary responsibilities of the board as described in Section 17 of Article XVI of the California Constitution."

The Administrator reported that MCERA received net proceeds of $53 million from the sale of Woodland Villas.

Mr. Wickman advised the Committee that one of the portfolio managers in the Oak Investments venture capital fund held in the original Abbott and Pathway private equity portfolios has been accused of fraudulent activity. Mr. Callahan explained that the Oak fund is considered venerable and this concerns one individual whose assets have been frozen. The issue at hand is a verification and internal control matter about whether a full investment has been made. Assets were frozen that cover the total amount of the alleged fraud. The Administrator and investment consultant will report on this matter when additional information is received.

Trustees Shore and Shaw were excused from the meeting at noon.

Ms. Heaphy reviewed the Quarterly Report as of March 31, 2015. Managers on the Watch List include RREEF which is winding down the value-added real estate portfolio. The Columbus Circle small cap portfolio experienced headwinds in the last two years as lower quality small caps outperformed high quality small caps. In response to Chair Brenk's inquiry, Mr. Callahan expressed confidence in the strategy longer term. The investment consultant stated that there has been an artificial market environment since the financial crisis that is difficult to manage for many active investment managers. He explained that low interests rates and accommodative monetary policy has hurt quality names across the market. The investment consultant emphasized the importance of sticking with strategies through different market cycles, noting that three years is a relatively short time frame for a long-term investment portfolio. The remaining manager on the Watch List is Parametric Emerging Market Funds due to trailing their benchmark for two years.

Ms. Heaphy reported that the total Fund value increased $37.3 million during the quarter to $2.05 billion, returning 2.19% net of fees (versus 2.08% for the composite benchmark). Asset allocations are within range of target allocations and total Fund returns over the past five years outperformed the composite benchmark as a result of the relatively high allocation to equities. Using proceeds from the sale of Woodland Villas, initial funding for the public real assets portfolio will be $102 million distributed equally across the four real asset classes.

Ms. Heaphy discussed performance attribution, noting the positive manager effect indicating asset allocations are on target. During the quarter domestic equity slightly underperformed the Russell 3000 index and the international, fixed income and real estate portfolios outperformed their benchmarks. Ms. Heaphy noted the divergence between growth and value as well as small and large cap stocks. During the quarter the overweight to small caps helped as they outperformed large caps. Performance details for each manager were reviewed by Ms. Heaphy.

Trustee Bolger asked if regulations in the Dodd-Frank Act have led to a liquidity issue in the bond market. In response Mr. Callahan said unquestionably there is a change in that previously major fixed income managers kept books of bond inventory and traded them freely. After the financial crisis over the counter bond activity has been reined in leading to less liquidity. He explained that the MCERA bond portfolio is designed to be very liquid with predominantly investment grade securities and provides diversification to equities. Mr. Callahan will continue to monitor liquidity through the fixed income managers.

Mr. Callahan pointed to metrics indicating that the private equity portfolio is showing its value. The time-weighted 5-year return of 11.64% is becoming a more valid number, he said, and outperforms the 9.57% return of the MSCI All Country World Index for global equities for that period.

In conclusion the investment consultant explained why the Parametric emerging markets portfolio is likely to deviate from the index from time to time. The strategy reweights the index away from the concentration of BRIC (Brazil, Russia, India, and China) countries that dominate the benchmark to more accurately represent their asset allocation that is more diversified and includes frontier countries. In summary Mr. Callahan said managers are performing well and there are no concerns.

There being no further business, Chair Brenk adjourned the meeting at 1:00 p.m.

Greg Brenk, Chair

Attest: Jeff Wickman
Retirement Administrator