

MINUTES

INVESTMENT COMMITTEE MEETING MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (MCERA)

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

December 15, 2016 – 9:00 a.m.

The Board of Retirement for the Marin County Employees' Retirement Association encourages a respectful presentation of public views to the Board. The Board, staff and public are expected to be polite and courteous, and refrain from questioning the character or motives of others. Please help create an atmosphere of respect during Board and Committee meetings. If members of the public wish to speak on any agenda items, please alert the Retirement Administrator to that request prior to the matter being called.

CALL TO ORDER

Chair Shore called the meeting to order at 9:00 a.m.

ROLL CALL

PRESENT: Bolger, Brenk, Given, Gladstern, Jones (alternate retired), Murphy, Shaw (ex officio alternate), Shore, Stevens, Thomas

ABSENT: Cooper, Piombo (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.

Open time for public expression, from three to five minutes per speaker, on items not on the Committee Agenda. While members of the public are welcome to address the Committee during this time on matters within the Committee's jurisdiction, except as otherwise permitted by the Ralph M. Brown Act (Government Code Sections 54950 et seq.), no deliberation or action may be taken by the Committee concerning a non-agenda item. Members of the Committee may (1) briefly respond to statements made or questions posed by persons addressing the Committee, (2) ask a question for clarification, or (3) provide a reference to staff for factual information.

B. MANAGER ANNUAL REPORTS

1. Manager Overview – Jim Callahan, Callan Associates

Jim Callahan, Executive Vice President with Callan Associates, introduced Senior Portfolio Manager Grady Smith and Vice President Ted Simpson of Dimensional Fund

Advisors who presented the annual review of the small cap value portfolio. Chair Shore recused himself and left the room as he has material financial interests in Dimensional Fund Advisors investments.

2. Dimensional Fund Advisors, Small Cap Value Equities – Ted Simpson, Grady Smith – 9:05 a.m.

Mr. Smith stated that the goal for the small cap value equity strategy is to outperform the Russell 2000 Value index over the long term using academic research. In the 12 months ended September 30, 2016, the Dimensional Fund Advisors Small Cap Value Equity portfolio returned 14.07% net of fees (versus 18.81% for the benchmark). Over the long term the portfolio has outperformed its benchmark. Mr. Smith explained that the strategy is driven by the academic world since the market pricing mechanism is good at embedding information in securities. As a result, it is difficult to outguess the market over time. According to Mr. Smith, historical data shows there is a tendency for small companies to outperform larger companies over time. In addition, the firm believes it is better to buy lower priced (value) stocks. In 2013 the firm determined profitability was material to performance and integrated this factor into the portfolio strategy.

The portfolio is designed to screen for sectors considered undesirable such as REITs and utilities. Mr. Smith noted these two sectors make up 20% of the benchmark and therefore the portfolio may underperform the benchmark in the short term. Mr. Smith discussed operational efficiencies, explaining that because there is illiquidity in the small cap space, there is a price to be paid for demanding liquidity. For this reason Dimensional's traders have latitude on which security to transact on any given day, with the idea being to be on the less expensive bid side of the trade.

Trustee Brenk noted that the utilities sector pulled back recently and asked whether performance had improved. In response Mr. Smith said the portfolio closed some of the performance gap year-to-date as of yesterday. Responding to Trustee Bolger's inquiry, Mr. Smith discussed performance of other Dimensional strategies that he said outperform over the long term. Mr. Smith noted that tracking area is an outcome of active management and that over long periods of time is how success is measured.

Trustee Gladstern inquired about percentage ownership limits with small cap stocks and Mr. Smith said ownership can be as much as 3 to 5% of a company. The largest holding as a percentage of the portfolio is generally around 1%, he said. The small cap universe in the U.S. is defined by Dimensional as the smallest 10% of equities.

Chair Shore rejoined the meeting at 9:27 a.m.

3. Wellington Management Company, Core Plus Fixed Income – Campe Goodman, Matt McLaughlin – 9:30 a.m.

Matt McLaughlin, Relationship Manager with Wellington Management Company, stated that the private partnership structure of Wellington enables it to attract and retain talent. Portfolio Manager Campe Goodman is a partner of the firm, Mr. McLaughlin noted. He stated that investment ideas are developed through market cycles. To eliminate conflicts of interest, the firm focuses solely on investment management.

Mr. Goodman stated that the goal of the core bond plus strategy is to outperform the Bloomberg Barclays Aggregate benchmark. The investment team delivers performance by managing interest rates across different credit sectors and through security selection. The Wellington core plus fixed income portfolio has outperformed the benchmark in the 12 months ending September 30, 2016, returning 6.73% net of fees (versus 5.19% for the benchmark). During the 4th quarter of 2016 there has been a pullback in fixed income due to rising interest rates, Mr. Goodman said.

Mr. Goodman reported that the largest contributors to performance this year have been good selections in significant allocations of high yield loans with floating rates and investment grade credit. For example, the portfolio manager added energy securities in March which helped performance. Structured finance securities are selected from the very top of the capital structure to insulate the portfolio from default risk. Going into the presidential election the portfolio was short duration and the subsequent rise in interest rates added to performance. Mr. Goodman is positive on credit generally and expects the U.S. economy to have steady growth going forward.

Trustee Stevens asked what changes have been made since 2008 and Mr. Goodman responded the team has been strengthened. Mr. Goodman held positions through the downturn during the financial crisis and therefore no principal was lost. Moving forward the portfolio duration is more in line with the benchmark because it is not clear if there will be a big move up in rates, Mr. Goodman said.

4. State Street, Securities Lending Program – John Powell – 9:55 a.m.

John Powell, Vice President of Business Development and Relationship Management with State Street, presented the annual review of the securities lending program. Mr. Powell reported securities lending revenue is up 15% from the prior calendar year, totaling \$177,613 as of October 31, 2016. Revenue is split 70% to MCERA and 30% to State Street. From the approved list of borrowers, 80% of securities loaned is with the top buyers.

Mr. Powell explained that market volatility has benefited performance. He attributed increasing revenue to market dynamics during 2016 including the market rise in the first quarter, Brexit, and the rising markets since the presidential election.

Trustee Thomas was excused from the meeting at 9:45 a.m.

The move from money market funds to government funds opened up opportunities for higher revenue which should continue into 2017, according to Mr. Powell. Due to the political environment Mr. Powell expects a definitive softening of financial market regulations.

Trustee Given joined the meeting at 10:02 a.m.

Mr. Powell explained that revenue levels are dependent on the amount of securities to loan which has dropped dramatically since the securities lending program was initiated.

Chair Shore recessed the meeting for a break at 10:08 a.m., reconvening at 10:20 a.m.

5. BlackRock, U.S. Treasury Inflation Protected Securities – Tom Holmes, Patricia Hunter, Laura May – 10:20 a.m.

Trish Hunter, Director of Institutional Client Business with BlackRock, introduced Associate Tom Holmes who stated BlackRock has expanded investment products and acts solely as a fiduciary to clients. Ms. Hunter stated that 2016 was a challenging year resulting in low returns for the BlackRock U.S. Treasury Inflation Protected Securities (TIPS) fund. Since the presidential election indicators are pointing to growth in the U.S. economy and increased consumption due to potential tax cuts. Ms. Hunter believes we have seen the lows in yields which will benefit the TIPS market going forward. In the 12 month period ending September 30, 2016, the BlackRock U.S. Treasury Inflation Protected Securities portfolio returned 6.75% net of fees (versus 6.58% for the benchmark).

Laura May, Fixed Income Product Strategist, stated the TIPS portfolio is passively managed against the Bloomberg Barclays U.S. TIPS Index and engages in securities lending for extra yield. Passive investment is a cost-efficient way to access the inflation market, she said. Her team believes tax cuts and infrastructure spending will cause deflation in the U.S. economy and she expects TIPS to outperform government bonds in the years ahead.

The investment team headed by Managing Director Scott Radell has grown by four people this year and emphasizes sector specialists. Proprietary systems help to manage return, risk and cost factors to deliver performance. Ms. May explained that the TIPS market is very liquid and the trading platform has the size and breadth to allow for best execution. Transaction costs are managed down to the basis point and determine the resulting attribution. The portfolio closely matches the underlying yield, duration and weighted-life of the benchmark.

6. Vanguard, REIT Index – Mark Landay, Jeffrey Brown – 10:45 a.m.

Trustee Bolger recused herself and left the room as she has a material financial interest in a Vanguard fund.

Trustee Given recused himself and left the room as he is the Chair of the Deferred Compensation Committee which is in a quiet period with respect to engaging Vanguard's services.

Mark Landay, Principal, Vanguard Institutional Investor Group, presented the review of the Vanguard REIT Index Fund. Product Manager Muhammad Raza Khan joined the meeting by conference call. Mr. Landay stated that Vanguard is the second largest asset manager in the world and uses economies of scale in managing investments. For succession planning Vanguard rotates portfolio managers among index portfolios and turnover is very low.

Trustee Thomas rejoined the meeting at 10:50 a.m.

Mr. Landay reported that REITs were just named the 11th market sector in the Global Industry Classification Standard (GICS) system. Formerly REITs were a sub-industry within the financial sector. The Vanguard REIT fund invests in equity real estate investment trusts, using full replication of entities in the benchmark index in the same

weight and proportion of the index. Tracking error is very small, with differences caused by the expense ratio and transaction costs. The Vanguard REIT Index Fund returned 19.73% net of fees (versus 19.83% for the benchmark MSCI REIT Index) in the 12 months ending September 30, 2016.

Mr. Landay stated the REIT sector has been a beneficiary of low interest rates in the last several years. After the presidential election REITs did not perform well as interest rates rose. According to Mr. Khan rising interest rates are a headwind for REITs because they rely on debt financing. As assets grow at Vanguard, ownership limits dictated by the SEC can be an issue. In response to Trustee Stevens' inquiry, Mr. Khan said in some cases a waiver is obtained for exceeding an ownership limit on a REIT. Mr. Khan said the Vanguard REIT Index fund represents 99% of the market cap of the U.S. real estate universe.

Trustees Bolger and Given rejoined the meeting at 11:13 a.m.

C. NEW BUSINESS

1. Due Diligence – Investment Manager Site Visit Reports

Consider and discuss recent due diligence site visits

a. Artisan Partners

Anne Heaphy, Vice President with Callan Associates, reported the due diligence team including Greg Brenk, Jeff Wickman, and Jim Callahan of Callan Associates conducted a site visit at Artisan Partners which manages the international growth portfolio. After meeting with portfolio managers, two analysts and a number of operational and trading people at Artisan Partners, there were no surprises. Compliance and trading operations are robust and no issues were found. Ms. Heaphy noted there is clear reliance on lead portfolio manager Mark Yockey as the key decision maker on the investment team. The report concludes the investment processes and portfolio management team are consistent and performance since inception has been strong. Callan Associates has confidence in the team and the firm.

In response to Trustee Shore's inquiry, Mr. Callahan stated Artisan's strategy is to capture global themes. This is a sign of an active, conviction weighted portfolio which is good. As the fund has grown in size, performance has still been good and he remains comfortable with the discipline.

Reporting for Mr. Wickman, Assistant Retirement Administrator Michelle Hardesty said the site visit was consistent with the site visit conducted three years ago. Trustee Brenk was impressed with Artisan's analysts and very strong platform.

2. Proxy Voting (Action)

Consider and take possible action on Governance Committee's recommendation to amend Investment Policy Statement regarding proxy voting implementation and reporting. Consider and take possible action on Governance Committee's recommendation to adopt expansion and renaming of existing Corporate Governance Policy to more directly address proxy voting.

Governance Committee Chair Gladstern stated that the intent of the Committee is to formalize oversight of proxy voting and provide guidance to managers on how proxies are voted. The Corporate Governance Policy duplicates the Council of Institutional Investors' (CII) policies on good corporate governance and now incorporates the proxy voting policy.

Ms. Dunning clarified that there already were a few differences between the precise terms of the CII policy and the MCERA policy although the MCERA policy tracks the CII policy; she also noted that recent CII amendments were included in the currently proposed edits to the MCERA policy. In addition, one operational item is bringing proxy voting reports to the Governance Committee to bring more consistent visibility to the process for Board members.

Assistant Retirement Administrator Michelle Hardesty stated that the Governance Committee is enhancing the Corporate Governance Policy to include proxy voting provisions and amend the Investment Policy Statement. Upon discussion Committee Chair Gladstern said this is a first step in the Committee's plan to build out processes around evaluating proxy votes. With the proposed policy updates the Committee will have the opportunity to address proxy voting matters, Ms. Hardesty said.

AYES: Bolger, Brenk, Given, Gladstern, Murphy, Shore, Stevens, Thomas
NOES: None
ABSTAIN: None
ABSENT: Cooper

3. Investment Policy Statement Updates (Action)

Consider and take possible action on recommended amendments to Investment Policy Statement re:

Mr. Callahan stated that updates to the Investment Policy Statement listed below bring the policy in line with prior actions of the Investment Committee.

It was M/S Bolger/Brenk to approve amendments C.3.a-m listed below to the Investment Policy Statement.

AYES: Bolger, Brenk, Given, Gladstern, Murphy, Shore, Stevens, Thomas
NOES: None
ABSTAIN: None
ABSENT: Cooper

- a. General Investment Objectives and Guidelines, Fixed Income and Real Assets Portfolios: Update the names of the bond indices
- b. Duties of Responsible Parties, Duties of the MCERA Board of Retirement: Add link to Trustee Due Diligence Policy and update link to Trustee Education Policy
- c. Appendix B-6, Pyramis Global Advisors, Statement of Objectives, Guidelines & Procedures: Change the firm name to Fidelity Institutional Asset Management

- d. Appendix B-7, Eaton Vance, Statement of Objectives, Guidelines & Procedures: Remove references to the Tax-Managed Emerging Markets Fund
- e. Appendix B-8, Wellington Management Company, Statement of Objectives, Guidelines & Procedures: Update the name of the bond index
- f. Appendix B-9, Western Asset Management, Statement of Objectives, Guidelines & Procedures: Update the name of the bond index
- g. Appendix B-11, BlackRock, US Treasury Inflation Protected Securities Fund, Statement of Objectives, Guidelines & Procedures: Update the name of the bond index
- h. Appendix B-12, BlackRock, Commodity Index Fund, Statement of Objectives, Guidelines & Procedures: Remove
- i. Appendix B-12, Invesco, Balanced-Risk Commodity, Statement of Objectives, Guidelines & Procedures: Add
- j. Appendix B-13, State Street Global Advisors, S&P Global LargeMidCap Natural Resources Index Fund, Statement of Objectives, Guidelines & Procedures: Remove
- k. Appendix B-13, KBI Global Investors, Global Resource Solutions, Statement of Objectives, Guidelines & Procedures: Add
- l. Appendix C-1, Pathway Capital Management Private Equity Funds, Statement of Objectives, Guidelines & Procedures: Add Pathway Private Equity Fund Investors 8
- m. Appendix C-2, Abbott Capital Management Private Equity Funds, Statement of Objectives, Guidelines & Procedures: Add Abbott Annual Program 2016, LP

D. INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE

For period ending September 30, 2016

In view of new managers added to the Watchlist, Mr. Callahan said it is reasonable to reconsider Watchlist criteria. Upon discussion there was general agreement that the Governance Committee would consider the matter. Ms. Heaphy reported that RREEF sold their last asset and the portfolio is in the final stages of liquidation.

Ms. Heaphy reported on Fund activity since the last quarterly report. The Parametric emerging markets portfolio has been consolidated into one vehicle, the collective investment trust. In the public real assets portfolio, the State Street Global Advisors natural resources portfolio was liquidated and transferred to the KBI Global Resources Fund at the end of September. Recently the Fund was rebalanced to move the Morgan Stanley and Artisan international portfolios back to targets by trimming the domestic equity S&P 500 Index Fund and Dimensional Small Cap Value portfolio.

As of September 30, 2016, the total Fund value was \$2.1 billion, an increase of 2.72% from the prior quarter. Ms. Heaphy attributed underperformance to the Composite Benchmark

return of 3.23% to the overweight to small caps. In the twelve months ending September 30, 2016, the Fund returned 9.57% versus 10.75% for the Composite Benchmark. Ms. Heaphy stated that over longer time frames the Fund is performing well as compared with the Composite Benchmark and peers. Short-term total Fund performance metrics are affected by the lag in private equity performance data, Mr. Callahan explained, noting that private equity assets have increased to over 8% of Fund assets.

Ms. Heaphy reported that the Fund's rolling three year standard deviation was closer to the median for the quarter ending September 30, 2016. The rolling three year Sharpe ratio shows positive performance. The attribution analysis shows the manager effect was a headwind due primarily to international portfolios that trailed benchmarks during the quarter.

Ms. Heaphy reviewed performance for each asset class and portfolio and discussed sector weightings that were positive or negative for the Fund. For example, currency exposure in international portfolios was negative and the emerging markets portfolio had a positive effect on Fund performance. Over 3 and 5 years the overall international equity portfolio has performed well on a relative basis. Callan's performance update through November 30, 2016 shows strong absolute year-to-date returns for domestic equities.

In quarterly results the fixed income portfolio returned 7.8% versus 6.3% for the benchmark and all managers outperformed for the quarter and prior 12 months. Ms. Heaphy noted that the Colchester global bond portfolio, which had been affected by currency exposure, had a positive turnaround. Mr. Callahan pointed out that the restructuring of the fixed income portfolio away from the Barclays Aggregate is working well and the fixed income managers are adding value to the Fund. He explained that fixed income assets were repositioned to diversify against interest rates rising in the U.S. Mr. Callahan said we will continue to monitor the performance of the fixed income portfolio in comparison to the Barclays Aggregate.

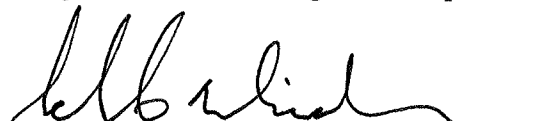
In the core real estate portfolios UBS and AEW slightly trailed the NFI-ODCE index, which Mr. Callahan attributed to their relatively low leverage. Over the long term income returns are very strong from both managers, as would be expected with low leverage, and the managers are expected to outperform in a negative environment, he said. Real asset portfolios are posting close to benchmark returns, with the Invesco Commodity Fund notably outperforming the Bloomberg Commodity Index for the quarter.

Ms. Heaphy discussed the performance update on year-to-date returns as of November 30, 2016 that reflect strong absolute returns in domestic equities and fixed income portfolios. The private equity portfolio has positive returns over 3 and 5 years. Mr. Callahan stated the time-weighted return of the private equity portfolio will become more meaningful over time. In response to Trustee Brenk's inquiry, the investment consultant said it is too early to determine whether the private equity portfolio will outperform public equities by 3%.

There being no further business, Chair Shore adjourned the meeting at 12:24 p.m.



Dave Shore, Chair



Attest: Jeff Wickman
Retirement Administrator