MINUTES

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

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

January 18, 2017 – 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 agendized 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: Cooper, Given, Gladstern, Jones (alternate retired), Murphy, Piombo (alternate safety), Shaw (ex officio alternate), Shore, Stevens, Thomas

ABSENT: Bolger

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 of Callan Associates, introduced managers presenting annual portfolio reviews. Colchester Global Investors manages the unhedged global fixed income portfolio and Western Asset Management Company manages the intermediate duration credit portfolio. In 2013 MCERA's fixed income portfolio was restructured to diversify away from U.S. Government securities to improve some of the characteristics of the portfolio. The Western Asset portfolio was moved from core plus to an intermediate credit mandate and the global fixed income portfolio was added to the Fund.

2. <u>Colchester Global Investors, Global Fixed Income – *Mamak Shahbazi – 9:05 a.m.*</u>

Mamak Shahbazi, President and co-founder of Colchester Global Investors, reported the firm's management team is stable. The investment strategy is to invest primarily in high-quality sovereign bond markets that offer attractive real yields over the medium term. In addition the portfolio is constructed with currencies acquired at a discounted value. The valuation of currency and bonds is separate and as a result there may be bonds in countries with no corresponding currency exposure (and vice versa). For the year ending December 31, 2016 the Colchester global fixed income portfolio returned 4.3% (versus 1.6% for the Citigroup World Government Bond Index).

Ms. Shahbazi discussed factors affecting portfolio performance during 2016 through November 30, 2016. Underweights to Europe, Japan and the United Kingdom (U.K.) hindered relative performance to the benchmark. The top three bond contributors to performance were overweights in Brazil, the United States and Australia. In the currency portfolio, overweights to the Japanese Yen, Brazilian Real and South African Rand led to significant outperformance. Overweights in Mexican, Swedish and Polish currencies detracted from relative performance.

Ms. Shahbazi discussed the bond and currency valuation process. Real yields for bonds are estimated based on the 10-year nominal yields less Colchester's two-year inflation forecast. Results show bonds of Europe, the U.K. and Japan have negative real yields and therefore have low value. The bonds of Singapore and New Zealand have positive real yields and a significant yield advantage. Ms. Shahbazi used a long-term chart showing how foreign currencies move relative to the U.S. Dollar as an indication of the tactical strategy for investing in currencies. Expected real returns for bond holdings and portfolio positioning relative to the benchmark were reviewed. As of November 30, 2016, the portfolio was underweight in the bonds of France, Germany, Italy, and United Kingdom that have relatively low real yield. The portfolio was overweight in the bonds of New Zealand, Australia, Norway, Mexico, and Singapore because they are considered more valuable. As noted, allocations are different for currencies because the investment analysis is based on a different set of metrics. For example, the currency portfolio is overweight the British Pound but the bond exposure is zero in the U.K. Based on valuations the bond portfolio was positioned a few years shorter in duration than the benchmark and overweight to inflation-protected securities.

In conclusion, Ms. Shahbazi stated Colchester's economic outlook is for moderate, steady global growth and a return to a "normal" historical inflation level, with no inflation shock expected. The United States is steadily leading the economic recovery from the global financial crisis.

In response to Trustee Stevens' inquiry, Ms. Shahbazi stated the contribution to performance of bonds and currencies varies in different periods over the years. During 2016 the currency portfolio returns led to outperformance to the benchmark. In general, Ms. Shahbazi expects bonds to contribute two-thirds of performance and currencies to contribute the remaining one-third. Chair Shore asked if the positive view on Brazilian currency a year ago was beneficial. In response Ms. Shahbazi reported it was a successful call as Brazilian bonds were up 16% for the year and Brazilian currency was up 17%, contributing significantly to portfolio performance for 2016. Currency positions may deviate substantially from the benchmark because currencies in the benchmark are static and fewer in number, Ms. Shahbazi explained in response to Trustee Gladstern's question.

3. Western Asset Management Company, Intermediate Credit Fixed Income – *Frances Coombes, Kurt Halvorson – 9:30 a.m.*

Frances Coombes, Client Service Executive with Western Asset Management Company, reported the firm added one senior member to head the non-U.S. Investment-Grade Credit Team. Ms. Coombes introduced Trader Kurt Halvorson to review the intermediate credit bond portfolio. The Western Asset intermediate credit portfolio returned 5.2% in 2016 (versus 3.7% for the Bloomberg Barclays U.S. Intermediate Credit Index).

Mr. Halvorson highlighted the consistent outperformance of the intermediate credit portfolio over the long term and through the financial crisis. He pointed out that portfolio management stuck with convictions on the fundamentals of the portfolio early in 2016 when there was extreme dislocation in the fixed income markets due in part to negative conditions in China. Subsequently the market reversed direction away from fear regarding China to hope combined with uncertainty given the political climate surrounding the presidential election in the United States.

The portfolio attribution analysis shows that issue selection was the biggest factor in the outperformance of the Western Asset portfolio in 2016. Mr. Halvorson stated this is a reflection of the quality and deep bench of the analyst team and its fundamental bottom-up analysis. He highlighted particularly good calls in the energy sector. The banking sector lagged but there are signs of recovery there. Responding to Trustee Stevens' inquiry, Mr. Halvorson indicated that sector and issue calls affect performance more than other factors. Ms. Coombes added that typically one-third of performance is attributed to top-down analysis and two-thirds to sector and issue positions.

A review of sector and credit quality portfolio allocations as of December 31, 2016 as compared with April of 2016 is evidence of de-risking the portfolio. Valuations have become less compelling, according to Mr. Halvorson. An example is the underweight to healthcare and pharmaceuticals due to relatively high valuations and substantial debt issuance. In addition high-yield issues have been trimmed from 9 to 7%. Mr. Halvorson reported the plan is to continue to lower the risk profile of the portfolio in 2017. There are indications of late-cycle conditions in the credit markets, such as spreads close to fair value, flat-lining earnings and a spike in mergers and acquisitions. Mr. Halvorson noted that negative yields in non-U.S. issues have been a tailwind for the portfolio.

C. NEW BUSINESS

1. Investment Manager Reporting for 2017 (**Action**)
   Consider and take possible action to schedule annual portfolio reviews by investment managers

   Mr. Wickman presented the proposed schedule for annual portfolio reviews by managers for 2017.

It was M/S Gladstern/Stevens to approve the Investment Manager Reporting Schedule for 2017.

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

2. Due Diligence (**Action**)
   Consider and take possible action on investment manager due diligence site visit schedule for 2017

   The Administrator presented a proposed due diligence site visit schedule for 2017 in accordance with the Due Diligence Policy provisions. Some site visits are carried over from last year. Past practice has been for the Administrator, investment consultant and the Chair of the Investment Committee to conduct the due diligence site visits.

It was M/S Stevens/Gladstern to approve the Investment Manager Due Diligence Site Visit Schedule for 2017.

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

3. Watchlist Status – RREEF
   Consider and take possible action to remove RREEF from the Watchlist

   Mr. Callahan presented a summary of the status of the RREEF America REIT III Fund. Over the past few years, the RREEF portfolio has been winding down and selling assets. Since there are no more assets remaining, Callan Associates recommends removing the RREEF portfolio from MCERA's Watchlist.

It was M/S Stevens/Murphy to remove the RREEF America REIT III Fund from the Watchlist.

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

Chair Shore recessed the meeting for a break at 10:10 a.m., reconvening at 10:15 a.m.

D. INVESTMENT CONSULTANT PERFORMANCE UPDATE

Mr. Callahan reported that preliminary results of Fund performance as of December 31, 2016 are indicative of a good calendar year in the capital markets. The domestic equity portfolio is up 13.5% gross of fees as compared to 12.7% for the Russell 3000 Index. He attributed the Fund's performance to the overweight to small cap equities, noting that small caps are expected to outperform large cap equities over the long term. International portfolios trailed the international composite that was flat for the year. Emerging markets were very strong until the fourth quarter of 2016. The MSCI Emerging Markets Index was up 11.2% for the year and the Parametric emerging markets portfolio added value, outperforming the benchmark with a 14.0% return gross of fees.

For the year the fixed income portfolio performed well, Mr. Callahan stated, returning 200 basis points ahead of the blended benchmark. All fixed income managers added significant value over their portfolios' respective indices. The fixed income markets rallied in the first half of the year and then interest rates began to rise in the second half of the year, causing bond prices to decline. The public real assets portfolio returned 11.1% gross of fees, as compared with 14.1% for the blended benchmark. Mr. Callahan observed that the KBI natural resources portfolio performed well in absolute terms and is likely to have tracking error due to differences from the benchmark S&P Global Natural Resources Index.

Core real estate managers AEW and UBS have lagged in a good real estate market as expected. Mr. Callahan explained that once appreciation slows down the real estate portfolios will have better relative performance because they are income-oriented portfolios.

There being no further business, Chair Shore adjourned the meeting at 10:23 a.m.

DN Shore

Dave Shore, Chair

Attest: Jeff Wickman
Retirement Administrator