

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

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

**March 22, 2017 – 9:00 a.m.**

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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, Given, Gladstern, Murphy, Piombo (alternate safety), Shaw (ex officio alternate), Shore, Silberstein, Stevens, Thomas

ABSENT: Cooper, Jones (alternate retired)

**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.

No public comment.

**B. MANAGER ANNUAL REPORTS**

1. Manager Overview – Jim Callahan, Callan Associates

Jim Callahan, Executive Vice President at Callan Associates, discussed the international equity markets as a preview for today's three international equity managers' annual portfolio reviews. International equity markets have been weak in the last few years as compared with the much stronger domestic equity markets. A big part of the relatively weak returns has been the strength of the U.S. Dollar and cross currents during 2016 that made it difficult for active managers. Mr. Callahan maintained that a diversified structure is appropriate for the long term and there are no outstanding issues with MCERA's international equity managers.

2. Fidelity Institutional Asset Management – Nick Horn, Art Greenwood – 9:05 a.m.

Art Greenwood, Relationship Management and Client Services representative with Fidelity Institutional Asset Management (FIAM) stated the select international small cap strategy is a fundamental developed-market strategy managed by Rob Feldman. Active stock selection drives returns and risk controls keep region, country and sector weights generally in line with the benchmark. Observing that last year was challenging, Mr. Greenwood noted long-term results are competitive to the benchmark.

Nick Horn, Institutional Small Cap Portfolio Manager, reported 2016 was driven by macro trends and modest returns for the international equity markets. The best performing sectors were energy, materials and utilities. Regionally, Canadian small caps benefited from strength in commodities and the United Kingdom had the worst performance in part as a result of the Brexit vote. Mr. Horn said increased volatility and sector rotation in 2016 resulted in a different theme for each quarter and a market reversion from top performers in 2015. Strength in European financials contributed to portfolio performance.

Trustee Silberstein inquired about fair value pricing which Mr. Horn explained involves adjusting the Net Asset Value (NAV) for the prior night's movements in other international markets. In response to Trustee Silberstein's further inquiries, Mr. Horn said MCERA's investment represents approximately 10% of the Select International Small Cap Fund and the investment team is not involved in assessing fair value. Trustee Stevens asked about small cap market capitalization limits and Mr. Horn indicated the normal zone is from \$1 to 3 billion. Trustee Gladstern requested a review of the investment decision-making process. In response Mr. Horn explained the focus is on stock-picking, using the Fidelity platform to identify value opportunities in a team-based approach. Analysts look for buy-rated names that fit market cap, risk and liquidity profiles. The best opportunities are selected to develop a benchmark-neutral portfolio as to region and sector. Exit signals include holdings approaching upside targets and mergers and acquisitions.

Trustee Silberstein asked about proxy voting processes and how often proxy votes are against management proposals. In response Mr. Greenwood offered to send the requested information including proxy voting guidelines to MCERA. Mr. Greenwood noted that FIAM uses outside proxy voting services and has a proxy voting team. To Mr. Silberstein's question of what factors affect proxy voting, Mr. Greenwood replied it is a balancing act and they do their best to make an informed judgment. Mr. Horn indicated generally the management teams will be supported since the investment would not otherwise have been made. Analysts have a quality bias and look for good management teams with strong governance.

3. Morgan Stanley, International Equities – Jill Ytuarte – 9:30 a.m.

Jill Ytuarte, Executive Director with Morgan Stanley, stated that the international equity strategy seeks long-term outperformance through investing in the highest quality companies. In assessing investment prospects the investment team looks in particular for price misalignments. Preservation of capital is a focus and therefore the portfolio is designed to to outperform when markets are challenged and is likely to underperform in strong markets. Ms. Ytuarte noted that on a free cash flow basis the portfolio is out-compounding the market.

Performance during 2016 was challenging for active bottom-up stock pickers, Ms. Ytuarte said. Strength in United Kingdom holdings was dampened by the Brexit theme that led to a declining British pound and thus flat returns when translated to the U.S. Dollar. The energy sector was up significantly and in the second half of 2016 there was almost a complete reversal with financials leading the way and defensives and health care down. Sector allocation drove underperformance to the benchmark, particularly the overweight to staples.

Currently the portfolio is positioned defensively from a historical perspective. Themes are quality companies and downside protection. The portfolio is overweight to consumer staples that grow cash at low cost, have a loyal customer base, and innovate on the margin to grow over time. The portfolio is underweight financials and the euro is considered a tail risk. Ms. Ytuarte stated that MSIM believes cyclical valuations are unsupportable after the multi-year bull market. Ms. Ytuarte pointed to the return on operating capital employed of 28% versus 12% for the index. In response to Chair Shore's inquiry, she said the free cash flow return is nearly 6%.

Responding to Trustee Silberstein's inquiries, Ms. Ytuarte said MCERA's portfolio is approximately \$136 million as compared with the total international equity pooled trust of \$2 billion. She believed that proxy votes are against management proposals 7 to 8% of the time but would provide the data to MCERA after the meeting. A significant amount of time is spent to ensure governance is high quality and will drive earnings with respect to how management is paid.

4. Artisan Partners, International Growth Equity – Andrew Euretig, Sean Howley – 9:55 a.m.

Sean Howley, Portfolio Specialist and Relationship Manager with Artisan Partners, reported that near the end of 2015 international markets were affected by uncertainty and volatility. The slowing Chinese economy had a ripple effect globally because many companies export to China; in addition, there were concerns about capital flowing out of the country. International bond yields turned negative and oil prices had troughed in the first quarter of 2016. Conditions improved in the second quarter of 2016 as China's economy stabilized and concerns over Brexit subsided. Markets and oil prices began to recover and a cyclical rally took hold on the U.S. presidential election.

Andrew Euretig, Portfolio Manager and Analyst, stated that the portfolio remained defensively positioned through 2016 and therefore underperformed the benchmark. The investment team continues to take a negative view on energy prices over the long term.

Mr. Euretig is positive on financials and views the rise in bond yields as reflective of a long-term trend and reflation. Less regulation is expected to be a tailwind for the financial sector. The portfolio is also overweight consumer staples. Mr. Euretig noted the portfolio is performing better in the first few months of 2017.

Trustee Bolger asked whether deregulating financial institutions is a good idea. In response Mr. Euretig said this is an internal debate but the investment team wants investors to participate in the anticipated upside. Responding to Trustee Silberstein's inquiries, Mr. Euretig said MCERA holds under \$150 million of the total \$4.7 billion Artisan International Fund. He estimated that proxy votes are against management proposals about 5% of the time. A report of the information would be provided separately after the meeting. Mr. Euretig actively engages with management teams and for every proxy vote the ISS recommendation and a list of red flags are considered. Trustee Gladstern asked about succession planning and Mr. Euretig indicated a structure is in place to share responsibilities and manage a transition if one were to occur although that is not expected to happen as Mr. Yockey continues to set the tone.

Chair Shore recessed the meeting for a break at 10:20 a.m. and reconvened at 10:33 a.m.

### **C. INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE**

For period ending December 31, 2016

Mr. Callahan explained in response to Trustee Stevens' inquiry that small capitalization stocks are more broadly defined in the international equity universe. Trustee Silberstein observed that in some cases MCERA's holdings represent 10% of the investment vehicle. Mr. Callahan explained that all managers manage multiple vehicles so MCERA represents a much smaller percentage of a manager's total assets under management. Typically MCERA needs to invest in pooled vehicles such as a mutual fund or commingled fund due to its relatively small size.

Mr. Callahan reported that over the long term the international equity portfolio has relatively strong returns. The investment consultant remains comfortable with the international managers and Fund diversification through periods of disparity between domestic and international performance. Anne Heaphy, Vice President with Callan Associates, reported that Artisan was recently added to the Watchlist. The quantitative criteria for the Watchlist will be reassessed by the Governance Committee at its April meeting. The Parametric portfolio is exceeding criteria and will be considered for removal from the Watchlist upon reevaluation of Watchlist criteria.

During the quarter ending December 31, 2016 the Parametric emerging markets portfolio assets were combined into the commingled trust that has a lower investment fee. Asset allocations are within target ranges. The total market value of the Fund as of December 31, 2016 was \$2.147 billion versus \$2.150 billion in the previous quarter. The total Fund returned 7.24% net of fees (versus 7.99% for the composite benchmark) for the 2016 calendar year. Over calendar year 3, 5 and 10 year periods the Fund outperformed the composite benchmark and ranks well among peers.

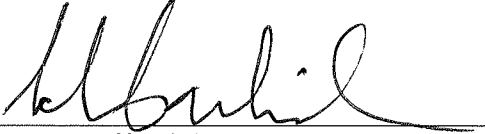
Ms. Heaphy reported the domestic equity portfolio returned 13.1% during 2016, balancing the flat performance of the international equity portfolio. Small cap equities outperformed and contributed to performance due to the overweight to small caps. The value oriented Dimensional small cap portfolio had strong performance in 2016. The Columbus Circle small cap portfolio has a quality bias and underperformed due to low quality equities benefiting from quantitative easing. In the first few months of 2017 the Columbus Circle portfolio shows signs of recovery as fundamentals are coming through and the Fed raises interest rates.

The Parametric emerging markets portfolio outperformed and benefited the Fund. The fixed income portfolio outperformed the benchmark during 2016, as did every active fixed income manager. The real assets portfolio was up 8.69% net of fees. The real estate portfolio trailed the index due to the low use of leverage in a strong market. Public real assets, in particular commodities and natural resources, performed well with double digit returns for the calendar year. Within the real assets portfolio, the natural resources portfolio differs from the S&P Global Natural Resources Index as it has no exposure to fossil fuels. Therefore in the short term the performance will vary from the benchmark, which remains an appropriate measure of performance over the long term, Mr. Callahan said. For reference the benchmark used by KBI will be included in the quarterly report.

In conclusion, Mr. Callahan stated that large cap U.S. equity has been the dominant performer over the last 5 to 7 years. The reason the Fund is diversified is to minimize drawdown in difficult markets. At the Board's April 17-18 Strategic Workshop Mr. Callahan will present updated capital market expectations.

There being no further business, Chair Shore adjourned the meeting at 11:20 a.m.

  
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Dave Shore, Chair

  
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Attest: Jeff Wickman  
Retirement Administrator