MINUTES

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

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

September 26, 2018 – 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 Given called the meeting to order at 9:03 a.m.

ROLL CALL

PRESENT: Block, Cooper, Given, Gladstern, Jones (alternate retired), Klein, Murphy, Shaw (ex officio alternate), Silberstein, Thomas, Werby

ABSENT: 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.

No members of the public provided comment.

B. MANAGER ANNUAL REPORTS

1. Manager Overview – *Jim Callahan, Callan Associates*

   Jim Callahan, President of Callan Associates (Callan), said the managers of MCERA's two private equity portfolios, Abbott Capital Management and Pathway Capital Management, will present annual portfolio reviews. In December Callan will present the private equity pacing analysis and information on private equity fees.

2. Abbott Capital Management – Private Equity – *Jonathan Roth, Charlie van Horne – 9:05 a.m.*

   Charlie van Horne, Managing Director and Client Relations Manager with Abbott Capital Management (Abbott), stated Abbott's sole focus is private equity, to which it commits approximately $1 billion per year to cycle-tested managers. Drivers of the firm's strategy include its deep relationships and networks, information advantage that is a valuable and critical part of investing in private equity, and focus advantage in identifying which groups belong in the portfolio in any economic environment.

Trustee Jones joined the meeting at 9:08 a.m.

Earlier MCERA received notice that Mr. van Horne would be leaving Abbott at the end of this calendar year. Mr. van Horne said Abbott has added resources in client relations to have a smooth transition and retain his standard of responsiveness.

Jonathan Roth, Managing Director and President, Abbott Capital Management, said MCERA selected Abbott to manage private equity ten years ago. Mr. Roth highlighted results as of March 31, 2018 for MCERA's first commitment of $100 million in the ACE VI fund: MCERA has received $68 million in distributions and the balance in the ACE VI fund is valued at $80 million. MCERA has made further commitments in new vehicles over time. Mr. Roth stated Abbott is picking managers who invest in companies that grow. He explained that in the ACE VI fund the 7% allocation to lower-middle buyout funds (secondaries) represents a collection of strong investments that contributed meaningfully to performance. Similarly, for the ACE VII fund, Abbott's allocation of 10% to secondaries to drive early liquidity has been successful. The ACE VII fund vintage years span from 2014 to 2017 and the net internal rate of return is 15%. Mr. Roth explained that secondary transactions are a tactic used to return money back to MCERA while longer term investments develop.

Abbott developed an annual program for follow-on funds that allow investors to customize portfolios. MCERA has chosen the model allocation for its commitments to AP 2016 and AP 2017, which Mr. Roth said replicated the previous strategies. AP 2016 is fully committed and is in the early phase of development. The allocation to secondaries of slightly less than 10% is expected to drive early returns.

In conclusion, Mr. Roth discussed cash flows for the ACE VI fund through August 31, 2018. During June, July and August 2018, ACE VI distributed an additional 10% of its committed capital. Mr. Roth expects the ACE VI fund to show considerable liquidity between now and the end of the year. He said due diligence and investing in cycle-tested managers steadily over vintage years is leading to success. Mr. van Horne introduced Abbott's next commingled fund offering, AP 2019.

Mr. Roth responded to trustee inquiries, explaining in response to Trustee Block's question that Abbott invested 1% of committed capital in vehicles ACE VI and ACE VII. Trustee Silberstein asked about secondaries in AP 2019 and Mr. Roth said AP 2019 has the flexibility to invest up to 20% in secondaries. He explained in response to Trustee Werby's inquiry on secondary pricing that historically there was a significant discount. Today, venture capital funds trade at about a 15% discount, and private equity funds trade close to 95%, in some cases more than 100%, of value.

Trustee Klein asked if valuations are stretched, why the allocation to secondaries would be increased. In response, Mr. Roth said his team is seeing a wider variety of opportunity sets with shorter durations. As an example, he discussed the opportunistic recapitalizing of a profitable company for a fund that needed to get out of the investment. Asked by Trustee Klein to elaborate on Abbott's information advantage, Mr. Roth referred to a list of Select Buyouts delivering outsized returns that were sourced through Abbott's network. In summary, Mr. Roth stated results demonstrate the success of being in business over thirty years, making observations and using contacts to find the next idea.

Trustee Silberstein asked if the narrowing of private equity outperformance to public equities will continue. Mr. Roth responded that with 13% to 14% net returns, private equity would be expected to show better relative performance when public equities return to historical performance levels. Mr. Roth noted there is a bigger opportunity set since more companies are staying private. Mr. Wickman thanked Mr. van Horne for his work with MCERA over the past ten years, saying he could always be relied on.

3. Pathway Capital Management – Private Equity – *Jim Reinhardt, Valerie Ruddick – 9:30 a.m.*

Jim Reinhardt, Senior Managing Director and Founder, Pathway Capital Management, summarized MCERA's investments in four Pathway private equity funds since 2008. The oldest fund, PPEF 2008, has a 12.75% internal rate of return as of June 30, 2018 and is in the harvest/liquidation phase. The remaining funds are in early development. Mr. Reinhardt stated in 2015 Pathway added co-investments that MCERA is not participating in. He pointed out that with distributions in 2017 and 2018, MCERA has become net cash flow positive, with more money coming back to MCERA than it has invested.

Valerie Ruddick, Managing Director with Pathway Capital Management, reported Pathway's private equity funds are well diversified across vintage years and 61 managers. There are 128 different investments in private equity partnerships since 2008, and over 2,000 different portfolio companies based in over 40 countries. The largest company position is about 2% of the total market value of the portfolio.

Trustee Cooper left the room at 9:55 a.m. and returned at 10:15 a.m.

Ms. Ruddick reviewed the performance of each of four funds MCERA has invested in. The first three funds are fully committed, and the last fund is expected to be fully committed over the next 12 months. Trustee Werby noticed fees had changed since 2008 and Ms. Ruddick explained that Pathway is charging less in the early stage of a fund's life cycle and the fee impact diminishes over time. The underlying performance of each fund by investment strategy and geographic region was reviewed, showing each is contributing to positive performance. In conclusion Ms. Ruddick stated continued upside remains in the portfolio.

Trustee Silberstein asked how much debt general partners use for buyouts, noting interest rates are increasing. In response, Ms. Ruddick stated leverage is about 4 times annual earnings and may be higher for some large transactions. Mr. Reinhardt said the managers are aware of the risks of leverage and are relatively conservative. Pathway discusses this risk with the managers and makes sure at what valuations capital is being put to work. Trustee Block asked about distressed debt and Ms. Ruddick stated private equity investments are partnerships buying debt securities in troubled companies and exiting at a higher valuation.

Trustee Gladstern inquired about fluctuations in MCERA's commitments between the two private equity managers. In response, Mr. Callahan explained complexities in the process of estimating the commitment to private equity. Variables considered include the total fund value, expected growth rate, and rates at which capital is called and distributions are returned to MCERA over time. Based on these calculations, adjustments are made in Callan's annual pacing analysis. Mr. Callahan stressed the importance of vintage year diversification and being aligned with the best general partners that gatekeepers like Abbott and Pathway can identify.

Trustee Cooper returned to the meeting at 10:15 a.m., and Trustee Thomas was excused from the meeting at 10:18 a.m.

Mr. Callahan observed that private equity fees are lower with increases in commitments. Trustee Silberstein indicated private equity fees are high and there is a need to weigh the net return for private equity as compared to alternative investments. Mr. Callahan replied it takes a long time to make that evaluation for a private equity portfolio.

Chair Given recessed the meeting for a break at 10:28 a.m., reconvening at 10:40 a.m.

Trustee Cooper was excused from the meeting at 10:30 a.m.

C. NEW BUSINESS

1. International Small Cap Equity Manager Selection (**Action**)
   Consider and take possible action to select manager for international small cap equity allocation

Mr. Callahan introduced Andy Iseri, Vice President for Global Manager Research at Callan Associates. Mr. Iseri provided an overview of firms being considered to replace Fidelity Institutional Asset Management (FIAM) as MCERA's international small cap equity manager. AQR Capital Management (AQR) is a quantitative firm using models to select stocks. In selecting investments, AQR considers fundamental factors such as value, growth rate, and manager quality. TimesSquare is a fundamental manager conducting research focused on getting to know the personalities and culture of companies they consider for investments. The third firm, Victory Capital, combines the strategies of AQR and TimesSquare by using quantitative methods and fundamental analysis. Mr. Iseri stated that the TimesSquare strategy has the most tracking error and Victory Capital's tracking error is in between the other two strategies. Trustee Block asked about the volatility of the benchmark and Mr. Iseri replied the MSCI EAFE Small Cap index is a developed markets benchmark; therefore TimesSquare, which has a small allocation to emerging markets, goes more outside the benchmark than the other two managers.

a. AQR Capital Management – *Rodolfo Martell, Iwan Djanali – 10:00 a.m.*

Iwan Djanali, Vice President of Client Strategies with AQR Capital Management (AQR), stated the theme is that it is not easy to outperform benchmark. AQR believes in diversification through systematic investing in companies with improving fundamentals and quality. Mr. Djanali highlighted the firm's proprietary models and published research.

Rodolfo Martell, Ph.D., Managing Director, Portfolio Management, with AQR, pointed out that there is one stock selection team across all the firm's strategies. The investment team employs a quantitative, systematic approach, using common sense with an academic grounding. The objective is to have balanced exposure to all the fundamentals in a repeatable and disciplined process. Dr. Martell said the benefit of the systematic approach is to proactively address and control risk in the portfolio construction process. There are a large number of holdings that are diversified across sectors and countries. The strategy is to have low to moderate turnover and look for efficiencies in trading costs. He explained in response to Trustee Silberstein's comment on turnover that quantitative strategies usually have turnover greater than 100%. The portfolio is rebalanced every three to four weeks and tightly controlled to the benchmark.

Dr. Martell stated the portfolio reflects the cumulative sum of implementation decisions made by the investment team along the way. For example, stocks that do not trade according to fundamentals are excluded from the portfolio. A daily analysis is computed to control risk early in the process. Stocks are ranked according to liquidity and robust optimization is used to determine when it makes sense to trade. Trades are executed carefully and patiently to provide liquidity in the market and not upset price.

In response to Trustee Silberstein's inquiry on how the strategy differs from that of Dimensional Fund Advisors (DFA), Dr. Martell stated they believe in momentum as an important factor and have a large set of value signals. Dr. Martell noted there are about 100 signals employed to detect momentum that include analyst data and sentiment to capture indirect momentum. Mr. Iseri added the biggest difference is that DFA uses fewer factors.

Trustee Block asked how dynamic the algorithm is and whether a computer is involved in the quantitative model. Dr. Martell replied that humans control the model and check the integrity of the data throughout the process. There is a constant evolution of the proprietary model to use new ways to capture value and momentum, as evidenced by the risk-adjusted performance of signals added since 2008. Trustee Block requested that each candidate disclose the name of the custodian; the custodian for AQR is State Street Bank.

b. TimesSquare Capital Management – *Magnus Larsson, Brenda Le – 10:35 a.m.*

Brenda Le, Senior Vice President and Head of Consultant Relations with TimesSquare Capital Management (TimesSquare), introduced Portfolio Manager Magnus Larsson, Director and Head of International Equity. Mr. Larsson differentiated his investment team based on the international makeup of its members. Within the international small cap strategy, emerging markets can be 7% of the portfolio, he said. Investment ideas are developed through a strong network of local individuals. Mr. Larsson said the investment process is based on bottom-up stock selection by visiting companies and focusing on those that are outstanding and successful. He emphasized the need to find the right managers and determine what they are thinking for the longer term. The investment team focuses on companies with a competitive advantage and sustainable business model that takes care of all stakeholders, including suppliers and society at large. Mr. Larsson believes these factors lead to the compound effect of consistent growth.

Mr. Larsson stressed, in implementing investment decisions, the importance of intrinsic value and using patience to wait for valuation to be favorable; the result is protection in market downturns. He stated that diversification is an automatic result of the investment method. In conclusion, Mr. Larsson said he believes strongly that the world is full of opportunities. Responding to Trustee Silberstein's inquiry, Mr. Larsson replied that turnover averages 40% to 50% per year and the average holding period is 4 to 5 years.

Ms. Le stated the strategy returns since 2012 are completive on a risk-adjusted basis, with lower volatility than the benchmark MSCI EAFE Small Cap (Net) Index. The custodian of TimesSquare is Bank of New York Mellon Corporation, or BNY Mellon.

c. Victory Capital Management – *John Evers, Steve Simpkin – 11:10 a.m.*

Steve Simpkin, Director for Institutional Markets with Trivalent Investments (Trivalent), stated Trivalent is a boutique owned by Victory Capital. Mr. Simpkin explained that the role of Victory Capital is to support non-investment activities for Trivalent. Mr. Simpkin introduced John Evers, Senior and Co-Portfolio Manager, who is the primary architect of the international small cap strategy. Mr. Evers stated Chief Investment Officer Daniel LeVan is a pioneer in international small cap investing. The investment strategy employs both quantitative and fundamental research with the objective of outperforming the benchmark and adding value on a consistent basis. The focus is on bottom-up stock selection and taking as much macro risk as possible out of the equation. Mr. Evers stated the investment team strives to work at the intersection of the quantitative and fundamental approaches. The quantitative models bring efficiency, discipline and focus to the table.

Further detailing the investment strategy, Mr. Evers emphasized the importance of the sell decision first, and secondly, knowing when to sell winners. Factors used by the quantitative model include return, quality of earnings, value, and business momentum – improving trends are important indicators. Valuation metrics include price/earnings ratios, price/book ratios, and forecasts for earnings before interest, taxes, depreciation and amortization. The proprietary quantitative model customizes the weighting of the factors considered. Each week, holdings that no longer meet the desired quantitative rating are reviewed. For every sell candidate, there is a buy candidate and analysts follow up with fundamental research.

In conclusion, Mr. Evers stressed the importance of understanding what is moving the success of a company and whether it continue. He stated the portfolio has low to moderate turnover and risk is controlled by keeping allocations close to the benchmark. Portfolio attribution showing stock selection drives alpha is a testament to the investment approach, Mr. Evers said. Responding to Trustee Silberstein's inquiry about succession planning, Mr. Evers said there are no current plans to change personnel, but they are considering bringing in younger team members. The custodian is SEI Trust.

Chair Given requested that Callan provide a summary of the three candidates. Mr. Iseri stated that AQR has an abundance of Ph.D.'s and computer power and is one of the most respected 'quant' firms. TimesSquare is doing personal fundamental research and specializes in the small cap sector. In response to Chair Given's inquiry, Mr. Iseri said TimesSquare held up well when the market was weak at the beginning of 2016. He said the TimesSquare strategy has had less time for a performance record, adding that Mr. Larsson is a well-respected portfolio manager. The Trivalent strategy is a blend of the strategies of the other two candidates.

In response to Trustee Klein's inquiry, Mr. Iseri said that TimesSquare would perform best in volatile markets. Trustee Block asked about risk and Mr. Callahan indicated that TimesSquare will have more volatility than the other two candidates. Trustee Block stated that he was impressed with the TimesSquare presentation and approach which capitalizes on picking winners.

It was M/S Block/Werby to select TimesSquare Capital Management as manager of the international small cap equity allocation.

The trustees shared insights and discussion was favorable to TimesSquare based on the hands-on research and performance; a consideration is key person risk.

AYES:	Block, Given, Jones, Klein, Silberstein, Werby
NOES:	Murphy
ABSTAIN:	None
ABSENT:	Cooper, Gladstern, Piombo, Thomas

Chair Given recessed the meeting for a lunch break at 12:45 p.m. and reconvened the meeting at 1:08 p.m.

D. INVESTMENT CONSULTANT QUARTERLY REPORT and PERFORMANCE UPDATE

As of June 30, 2018

Mr. Callahan reported the Fund had a good fiscal year with a preliminary net return over 9% as of June 30, 2018. The U.S. equity market continues to be a leader, and small cap has been positive in 2018. Active management has been positive for the Fund. Over the past 5 to 7 years, the capital markets have been driven by U.S equities. The emerging markets rolled over earlier this year and there will be mixed returns from international equities. In fixed income, the yield curve is much flatter as the Federal Reserve continues to raise the federal funds rate. Trustee Block asked when longer term rates are expected to rise, and Mr. Callahan explained that may happen when foreign investors stop buying U.S. Treasury's. Another factor is demand for longer duration debt from corporations hedging pension liabilities as a risk-mitigation strategy. Mr. Callahan pointed out that an inverted yield curve (when short-term interest rates are higher than long-term interest rates) does not always lead to a recession.

Mr. Callahan said the economy continues to be good. Wages show signs of increasing and other inflation indicators are pointing to higher inflation. The rest of the world is different, he said, as the economies of both Europe and Japan have experienced slowdowns recently. The strong U.S. Dollar hurts non-U.S. equity performance, acting as a headwind.

Anne Heaphy, Senior Vice President with Callan Associates, reviewed the watchlist. Ms. Heaphy said the organizational matters at Dimensional Fund Advisors and Morgan Stanley have not had an impact on those portfolios. Portfolio manager changes at FIAM were the impetus for today's interviews for a manager for the international small cap allocation.

As of June 30, 2018, the Total Fund value was $2.5 billion, a net increase of approximately $22 million from the prior quarter. There were no changes to asset classes during the quarter, and allocations are within target ranges. Performance for the fiscal year places the Fund in the 18th percentile of the Callan Public Fund Sponsor database. The Fund returned a preliminary 9.11% net of fees for the fiscal year, and outperformed peers over longer time periods on a net-of-fee basis.

Reviewing the performance of asset classes, Ms. Heaphy stated that the overweight to small cap was a benefit to the Fund, with small cap managers Dimensional Fund Advisors and Columbus Circle outperforming respective benchmarks for the last year. International equities are in line, with the Morgan Stanley international value portfolio slightly trailing over the past year. The Artisan and FIAM equity portfolios outperformed respective benchmarks for the year. Because of its underweight to China, the Parametric emerging markets portfolio underperformed its benchmark.

The fixed income portfolio was up marginally over the past year, and real assets returned 6.59% net of fees for the fiscal year. The UBS core real estate portfolio slightly trailed the AEW core real estate portfolio due to its lower leverage. The BlackRock Treasury Inflation-Protected Securities (TIPS) and REIT Indices had strong performance in the quarter. The actively managed Invesco commodities fund trailed its index for the quarter due in part to tariffs, and outperformed over the past year. The KBI Global Resources Fund trailed the market benchmark because oil has done well, outperforming its custom benchmark. Mr. Wickman reminded the Board that final June 30, 2018 valuations for the private equity portfolios lag and therefore will be reflected in the report for the next quarter.

There being no further business, Chair Given adjourned the meeting at 1:31 p.m.

Roy Given, Chair

Attest: Jeff Wickman
Retirement Administrator