

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

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

January 20, 2021 – 9:00 a.m.

This meeting was held via videoconference pursuant to Executive Order N-25-20, issued by Governor Newsom on March 12, 2020, Executive Order N-29-20, issued by Governor Newsom on March 17, 2020, and Executive Order N-35-20, issued by Governor Newsom on March 21, 2020. The public was able to listen to and observe the meeting on YouTube and make comments on Zoom.

CALL TO ORDER

Chair Klein called the meeting to order at 9:01 a.m.

ROLL CALL

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

ABSENT: None

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 REPORTS

1. Manager Overview – Jim Callahan, Callan LLC

Jim Callahan, President of Callan LLC, said the Western Asset Management fixed income portfolio is one of three actively managed fixed income portfolios in the Fund. Its intermediate credit mandate represents one quarter of the fixed income portfolio. Western Asset has been able to take advantage of adjustments to its guidelines by capturing incremental returns from some of the disruptions in fixed income due to the pandemic.

2. Western Asset Management – Intermediate Credit - Kurt Halvorson, Frances Coombes

Frances Coombes, Relationship Manager with Western Asset, introduced Kurt Halvorson, a Portfolio Manager who works with Portfolio Manager Ryan Brist. Ms. Coombes stated that Western Asset is focused solely on fixed income. The intermediate credit portfolio consists mainly of U.S. investment grade credit with the objective of outperforming the Bloomberg Barclays U.S. Intermediate Credit USD Unhedged Index by 100 basis point. In preliminary returns, the Western Asset intermediate credit fixed income portfolio (“portfolio”) returned 10.0% versus 7.1% for the benchmark for the calendar year ending December 31, 2020.

Mr. Halvorson presented a chart showing that the portfolio’s outperformance to the benchmark has increased since the mandate adjustment referenced above. This adjustment added a bucket for a high yield sleeve of up to 30% of the portfolio. Currently this high yield sleeve has an 11% allocation. The relatively low allocation is due to credit spreads receding all the way back to levels one year ago. Mr. Halvorson explained that this means the opportunity set is lower, so this is not the time for reaching for yield. As a result, the overall risk profile for the portfolio is closer to the benchmark at this time.

In performance attribution, issue selection took advantage of volatility, particularly in the new issue market, and was a big source of performance over the past year. Quality was also a positive contributor to portfolio results, and duration was a modest positive to results. Sector attribution was a negative due to bad timing in the energy sector from a macro standpoint. Mr. Halvorson stated the strategy is to stick with the energy sector due to favorable valuations and disciplined companies with supportive fundamentals. The team is getting more comfortable with the communications sector with a neutral weighting. Many sectors such as travel and leisure have question marks as to the path forward.

The investment team continues to migrate the portfolio to lower risk to be prudent. The view on interest rates is there will not be a substantial move higher from current levels. Trustee Silberstein inquired about the 7.7% cash position. Mr. Halvorson responded the elevated cash position is a function of a tactical move heading into year end. The plan is to deploy capital in new issuances of corporate supply in January. Currently the cash level is around 5% as the team is being patient with the opportunity set.

C. NEW BUSINESS

1. Proxy Voting Services (Action) – Institutional Shareholder Services – Joshua Russell, Nathan Worthington, and Jack Ferdon

Consider, discuss, and take possible action regarding proxy voting provider

Mr. Wickman introduced Joshua Russell, Senior Account Executive, Nathan Worthington, Managing Director and Regional Head of Client Service and Consultants, and Jack Ferdon, Senior Client Service Associate, of Institutional Shareholder Services (ISS). They will present ISS proxy voting services for the Investment Committee's consideration. This is a follow-on to last month's educational presentation on proxy voting.

Mr. Worthington said MCERA's current Proxy Voting and Corporate Governance Policy is straightforward and aligns with good governance at publicly traded companies. There are some gaps as compared with the ISS Benchmark Policy, he said; for example, a process for considering proxy contests where a dissident looks to get a seat on the board. He suggested a framework is needed to evaluate these situations. ISS looks at these cases by case and considers how shareholder value will be enhanced. These guidelines are available in off-the-shelf ISS benchmark or thematic guidelines, Mr. Worthington said.

Trustee Silberstein noted that MCERA's proxy voting policy conforms most closely to the ISS Public Fund Policy, particularly in the areas of auditors. He indicated that auditing is where we gain confidence in the financial statements, so it is good governance to assure the auditors do their job. Trustee Gladstern also recommended the Public Fund Policy. Mr. Worthington agreed the Public Fund Policy is a good option to choose. There are six thematic policies, and the ability to create a custom policy.

Trustee Block asked whether there are policy differences with respect to mergers and acquisitions. Mr. Worthington indicated that the language is effectively the same for the Public Fund Policy and the Benchmark Policy. He reviewed voting results of different policies to show what to expect.

Mr. Russell outlined proxy voting solutions for MCERA which include a fully outsourced proxy voting service based on one of the pre-existing ISS policies. The amount of research and volume of meetings drives cost. Mr. Russell estimated MCERA's domestic equity portfolios would entail about 2,200 corporate board meetings per year.

MCERA will have a client service consultant and access to an online proxy voting platform showing upcoming votes. The platform provides reports MCERA can choose to receive and alerts available through email. Trustee Thomas asked about training and support time and Mr. Russell said the client will receive whatever help is needed. Mr. Worthington added MCERA will receive an update on any policy changes from year to year and be informed about hot topics. A post-proxy season analysis is also available.

Mr. Russell presented three proxy voting service options, each with price breaks for up to three years. The first is based on the ISS Benchmark Policy. The second option includes the Public Fund Policy, and the third option is based on a custom policy with higher fees. Trustee Block asked how MCERA can be assured ISS votes align with policies. Mr. Worthington replied MCERA can receive an annual report showing voting results with

respect to the related policy. Also, ISS has third-party certification by Deloitte and Touche.

Mr. Ferdon discussed the three-step onboarding process that begins with setting up an account at ISS. Step two will recode the accounts to send ballots to ISS. In the third step MCERA staff is set up on the ISS proxy exchange with selected automated reporting. Mr. Worthington noted two documents will cover the service agreement and account details.

Trustee Silberstein finds using the ISS proxy voting system is straightforward, and Mr. Wickman agreed his expectation is that functionality is user friendly. Trustee Cooper asked about usage of the different policy options and Mr. Wickman replied most peer systems use the Public Fund Policy.

It was M/S Silberstein/Gladstern to hire Institutional Shareholder Services to vote MCERA's shares in the State Street Global Advisors S&P 500 portfolio and the Dimensional Fund Advisors Small Cap Core using the ISS Public Fund Policy with a preference for a three year contract.

Trustee Block thanked Trustees Gladstern and Silberstein for sponsoring this proxy voting initiative. He inquired about a price comparison with other providers and Trustee Silberstein replied Glass Lewis would likely be more expensive.

The motion was approved by a vote of 9-0 as follows:

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

2. Small Cap Tilt Within the Domestic Equity Portfolio (Action) – Jim Callahan, Callan LLC
Consider, discuss, and take possible action regarding small cap tilt in domestic equity portfolio

Mr. Callahan discussed the small cap tilt within the domestic equity portfolio. The current small cap U.S. equity allocation is 30% versus 70% for the large cap core allocation. The Russell 3000 Index allocation has a lower small cap weighting, 21% small cap versus 79% large cap. Mr. Callahan said the question is whether to change the MCERA small cap allocation. Anywhere between a market weight for small cap equities and 30% is reasonable, he said. Small cap stocks tend to be more volatile over time, meaning any allocation difference from the benchmark creates a higher tracking area against the benchmark.

Mr. Callahan explained that the overweight to small cap is based on its outperformance over the long term. In recent years this has not been the case. There is also an expectation for successful active management in the small cap space. Trustee Gladstern asked whether the domestic equity allocation is missing Small-Mid Capitalization stocks (SMID) and Mr. Callahan replied to some extent, yes. He said the Russell 3000 is a large cap index that goes further down in capitalization than the S&P 500 Index. The Russell 2500 benchmark is a SMID cap benchmark.

Mr. Callahan stated the active management premium for small cap still exists. The move to the DFA core small cap portfolio increased diversification and reduced the active management premium. He observed that small cap led the way out of the financial crisis. Mr. Callahan presented a rolling three year performance comparison of small cap with large cap equities.

Three alternative allocations proposed by Callan are:

1. 30%/70% small cap to large cap – the current allocation
2. 25%/75% small cap to large cap
3. 20%/80% small cap to large cap

As the small cap allocation is reduced, Mr. Callahan said, there is a corresponding reduction in volatility of the domestic equity portfolio as compared with the benchmark Russell 3000 Index. In addition, modest fee savings accompany a reduced small cap allocation. Mr. Callahan suggested using a 20%/80% small cap to large cap equity allocation which leaves a small cap tilt in the portfolio.

Trustee Klein asked about moving some small cap funds to a mid-cap manager. In response Mr. Callahan said Callan can bring some alternative structures utilizing passive vehicles to capture mid-cap stocks. Trustee Gladstern inquired if expanding the DFA mandate is a reasonable alternative. Mr. Callahan said DFA does not currently have a mid-cap option but may be willing to consider it. He noted the Russell 1000 Index has more exposure to mid-cap equities. These are reasonable alternatives to consider, he said.

Trustee Murphy asked when the small cap tilt stopped benefiting returns. In response, Mr. Callahan said from 2008 through 2013 small caps outperformed large cap and since then have underperformed except for 2016. Trustee Block indicated the time frame and return to the mean are considerations. Trustee Silberstein pointed out MCERA also has small cap equities in the private equity portfolio.

In conclusion, Mr. Callahan noted small cap equities have outperformed large cap equities over the past quarter and year to date. Trustee Silberstein suggested considering moving the S&P 500 portfolio to the Russell 1000 portfolio. Chair Klein said based on discussions the direction is for Callan to look into alternatives for getting into the mid-cap space. Mr. Callahan will follow up and indicated for mid-cap equities in the initial analysis Callan can present index alternatives.

3. Investment Manager Personnel Updates

a. AEW Capital Management

Mr. Callahan reported that AEW has announced management changes. He said these are not of concern to Callan because they have to do with creating succession planning down the line.

b. TimesSquare Capital Management LLC

TimesSquare announced it parted ways with one of the analysts on the international small cap portfolio team. His responsibilities are being absorbed by other team members and the change is not of concern to Callan.

D. INVESTMENT CONSULTANT PERFORMANCE UPDATE

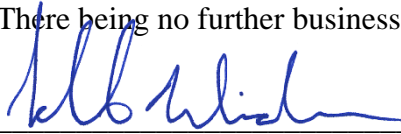
1. Flash Performance Update as of December 31, 2020

Mr. Callahan reported on preliminary fiscal year-to-date portfolio returns as of December 31, 2020. Domestic equity returns are up a strong 25.7% versus 25.2% for the benchmark. He pointed out this outperformance comes from the small cap overweight to the benchmark. International equities were up 21.2%, slightly behind the benchmark. The fixed income portfolio is up 5.0% for the fiscal year to date, outperforming the blended benchmark return of 2.8%. Colchester was the best performing fixed income manager, up 9.5% for the fiscal year to date.

Public real assets returned 22.7% versus 15.7% for the blended benchmark. The investment consultant highlighted the Invesco commodities performance of 28.1% versus 20.2% for its benchmark, and the KBI natural resources portfolio 41.9% return versus 21.1% for its benchmark.

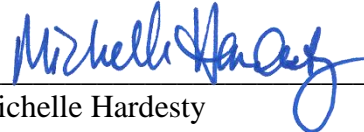
In summary, Mr. Callahan stated the fiscal year-to-date preliminary total Fund return is up 15.0%. The portfolio is working well, he said, and Callan will be presenting alternatives for the emerging markets allocation at the next meeting.

There being no further business, Chair Klein adjourned the meeting at 11:25 a.m.



Jeff Wickman
Retirement Administrator

On behalf of:
Sara Klein
Investment Committee Chair



Michelle Hardesty
Assistant Retirement Administrator

On behalf of:
Jeff Wickman
Retirement Administrator