MINUTES

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

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

June 16, 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 and provide comment through Zoom.

CALL TO ORDER

Chair Klein called the meeting to order at 9:02 a.m.

ROLL CALL

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

ABSENT: Shaw (ex officio alternate)

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 KBI Global Investors manages the natural resources investment, a component of the real assets portfolio, presented today for review.

2. KBI Global Investors Ltd – Global Resources Solutions Equities – Noel O'Halloran, Simon Padley

   Simon Padley, Senior Vice President for Business Development and Client Services with KBI Global Investors Ltd., introduced Noel O'Halloran, Lead Portfolio Manager, Director, and Chief Investment Officer for the Global Resources Solutions Strategy. Mr. Padley reported that sustainable natural resources assets under management for the firm have grown significantly. He said there are multiple-decade tailwinds in the space including supply, infrastructure, and significant technological developments. The firm fully integrates Environmental, Social, and Governance (ESG) into stock pricing models and how the portfolio is constructed. The portfolio has a significant impact in achieving United Nations Sustainability Goals and solutions to climate change issues, such as desalination and wind energy. Proxies are voted in a sustainable manner based on ESG guidelines and analysts have been added to deepen the team. As of March 31, 2021, the Global Resources Solutions Equities fund has a 14.6% net-of-fees annual return since inception in September 2016.

   Mr. O'Halloran said performance over the past five years has been good for the strategy which is outperforming the S&P Global Natural Resources Index benchmark. He explained that the first goal is to achieve alpha through good stock picking over time. Secondly, the strategy looks to future technologies and services driving the transition to a more sustainable economy that are expected to continue. There is a strong thesis that existing investments in natural resources such as fossil fuels involve risk and may be mispriced. As a result the portfolio invests in sectors such as clean energy, water infrastructure, and a broader agricultural solutions set that have worked well in recent years. The Portfolio Manager emphasized the differences of the portfolio strategy and holdings from the S&P Global Natural Resources Index, which is dominated by metals and mining, and oil and gas. The portfolio has no exposure to fossil fuels.

   Headwinds along the way include the China trade issue and the Covid-19 crisis. Relative performance during oil price hikes is getting better, which Mr. Halloran demonstrated with data showing the cost competitive advantages of clean energy. This year the strongest component of the portfolio has been agribusiness, which is correlated particularly to soft commodity inflation. Mr. O'Halloran said inflation in energy costs further improves investment in renewables and energy efficiency measures, and the portfolio is well positioned for more inflation. Clean energy has been the best performing sector since the inception of the strategy.

   Mr. O'Halloran provided details on individual companies in different sectors, noting that China's focus on clean water is benefiting portfolio holdings. One firm, Trimble, is an industry leader in navigation systems for tractors to allow more precise use of land. Reviewing diversification metrics, Mr. O'Halloran said the U.S represents 37.3% of the portfolio and Europe and emerging markets together represent about 48% in close to equal measures each. The portfolio is also diversified across capitalization and value versus growth companies.

In summary, Mr. O'Halloran said currently the biggest sector weighting is energy efficiency, including smart grid and lithium batteries. He said portfolio valuations compare favorably relative to benchmarks and discussed long-term supporting trends that are getting stronger in terms of money spent. Short-term factors supporting the portfolio include fiscal stimulus and Green Deal spending.

Trustee Gladstern asked if there is an improved benchmark for the portfolio. Mr. Padley replied the S&P Global Natural Resources Index is the common one to use and Mr. Callahan agreed. Chair Klein asked about companies addressing severe drought around the world. Saying the recognition of the need for improved infrastructure is important, Mr. O'Halloran replied that many companies provide pumps and valves that would be used in the solution of proper water storage. The other focus is on water reuse; for example, Barcelona drinking water is reused ten times. He explained that desalination is energy intensive and has environmental issues. Mr. Padley noted Los Angeles is focusing on water reuse, emergency water, and infrastructure investments.

C. NEW BUSINESS

1. Domestic Equity Portfolio (**Action**)
   Consider and take possible action regarding small cap tilt in the domestic equity portfolio

   Mr. Callahan discussed the small cap tilt in the domestic equity portfolio. He said current allocations for the domestic equity portfolio are 70% in the S&P 500 and 30% in the Dimensional Fund Advisors (DFA) small cap core equities. Deviations from the benchmark are driven by a significant overweight to small cap stocks versus the benchmark Russell 3000 Index. Mr. Callahan said the question is whether this overweight is still appropriate and whether to reduce it.

   The Investment Consultant stated that the rationale for the small cap overweight is research going back to the 1920's showing small cap equities outperform large cap over time. Additionally, small caps are not covered as extensively as large caps, so active management can be more effective in achieving alpha. Mr. Callahan stated the time frame needed to achieve the historical norm is 30 years, and small cap underperformance can last for extended periods of time. Some argue that the period used for the research on small cap performance was distorted because small cap access and liquidity was relatively minimal in years past as compared with today. Other factors affecting relative small cap performance are the explosion of exchange-traded funds (ETFs) and online brokerage services.

   Mr. Callahan's said he is comfortable maintaining a small cap bias but at a reduced level of 20% of the domestic equity portfolio, which is a typical allocation for peers. Noting that reasons seem to relate to market inefficiencies, Trustee Block asked if there are economic reasons why small companies would have more income than larger companies. Mr. Callahan replied that would depend on the industry. As to his further question of whether small companies have greater opportunities, Mr. Callahan replied it is difficult to generalize about that across industry sectors and there are smaller companies that can generate good returns.

Trustee Silberstein asked if reducing the DFA allocation and moving the S&P 500 to the Russell 1000 would include more mid cap equities and Mr. Callahan confirmed this would be the case. Trustee Silberstein observed that since small caps have outperformed in the twelve months ending March 31, 2021, now would be a good time to reduce the small cap allocation. Since then the small cap outperformance has repressed considerably, Mr. Callahan said.

It was M/S Gladstern/Silberstein to reduce small cap equities to 20% of the domestic equity portfolio and change the S&P 500 portfolio to the Russell 1000, transitioning the small cap portfolio to large cap in multiple stages over an appropriate time frame based on conversations with Dimensional Fund Advisors.

Mr. Callahan said making the transition in steps would allow for managing transaction costs, and the large cap portfolio would be easier to transition. Trustee Block asked if this recommendation is based on governance risk or the outlook on small cap performance. Mr. Callahan replied it is not driven by an outlook on small cap stocks but by the added volatility to the Fund by having the small cap overweight. He said it is also a combination of governance in someone making a wrong timing decision, but the added volatility from a larger allocation to small cap is the concern. Trustee Block asked if we have been adequately compensated for the small cap tilt given the risk. Mr. Callahan replied with a small cap allocation between 20 to 30% MCERA is getting paid for the risk; below a 20% small cap allocation, the Sharpe ratio starts to deteriorate meaning MCERA would not be paid for the risk.

Trustee Werby indicated the long-term perspective on small cap outperformance may still be valid. Mr. Callahan said that is a fair counterpoint; however, the composition of the small cap portfolio was different when the allocation was increased to 30%, whereas now the DFA strategy is not by fundamental company research but broad diversification according to style and value. Trustee Murphy supported Trustee Werby’s view, including his concern about large cap FAANG (Facebook, Apple, Amazon, Netflix, and Google) stocks. Trustee Block asked what percentage of the total equity portfolio is in small cap stocks, and Mr. Callahan replied in aggregate 12 to 14% of total Fund assets is in smaller companies.

Trustee Cooper made an alternative motion to reduce small cap equities from 30% to 25% of the domestic equity portfolio and increase large cap domestic equities to 75%, changing the S&P 500 portfolio to the Russell 1000 and transitioning the small cap portfolio in multiple stages over an appropriate time frame based on conversations with Dimensional Fund Advisors. Trustee Block seconded the motion. The motion was approved by a vote of 8-1 as follows:

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

2. <u>Investment Policy Statement Updates (**Action**)</u>
   Consider and take possible action on recommended amendments to Investment Policy Statement re:

   Mr. Wickman presented updates to the Investment Policy Statement for consideration by the Committee. Along with the addition of new Opportunistic managers, other updates were made as a result of taking a holistic view of the policy. These include clarifying the Board's role versus the Investment Committee's role and updating private equity and proxy voting provisions.

   Counsel Dunning explained updates reflect the way the Board has delegated investment responsibilities to the Investment Committee under its Charter. In addition, on some occasions the Governance Committee will consider matters that would go back through the Board rather than the Investment Committee. Mr. Wickman said edits in the Proxy Voting section align with the hiring of Institutional Shareholder Services (ISS) to vote proxies on MCERA's behalf for the Dimensional Fund Advisors and State Street Global Advisors portfolios. Trustee Block said it would be better practice to limit proxy voting provisions to the Proxy Voting and Governance Policy, and Trustee Poirier supported his view so the policies both align. Mr. Wickman agreed the Proxy Voting section can be amended just to reflect that proxy voting is governed by the related policy.

   Anne Heaphy, Senior Vice President with Callan, explained other updates include delineating between public and private market managers. She said the private equity section was modernized to reflect guidelines more in line with what the managers are doing. For example, co-investments and secondaries were increased from 20 to 35% and the life of private equity vehicles was extended to 15 years from 12 years. Also, private equity managers have moved to annual programs for raising funds. The Opportunistic allocation phrasing is broad since guidelines are provided in the fund documents.

   Regarding the change to manager reporting requirements, Trustee Block said he understands it is governed by fund documents, but is concerned about how we signal our policies around reporting and what replaces the oversight. Ms. Heaphy replied that in its due diligence Callan reviews manager reports to assess the quality of the investments and ascertain they are good investments for the Board. Mr. Wickman added that staff and counsel also review all fund documents to determine MCERA receives adequate reporting. Trustee Block indicated the Board may want to have a policy around reporting.

Trustee Cooper was excused from the meeting at 11:02 a.m.

It was M/S Gladstern/Murphy to approve updates to the Investment Policy Statement listed in Agenda Items B.3.a – q below, subject to the changes to the Proxy Voting section discussed above. The motion was approved by a vote of 9-0 as follows:

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

a. Introduction: Modify composition of Board of Retirement.

b. General Investment Objectives and Guidelines: Add Opportunistic Portfolio.

c. Investment Management Policy: Remove manager quarterly certification to compliance with guidelines.

d. Private Equity Policy
   1. Clarify direct investments by managers are known as secondaries or co-investments and increase allocation of same to 35% from 25% of portfolio.

   2. Increase life of vehicle to 15 years from 12 years and increase performance period to 10 rolling years from 5 rolling years.

   3. Define combined public market equity benchmark; generalize IRR performance benchmark.

   4. Remove the Fund's investment limit of 20% of a private equity fund-of-funds total value.

e. Duties of Responsible Parties
   1. MCERA Board of Retirement: Remove guideline certification from portfolio review.

   2. Investment Managers: Categorize as public or private markets.

   3. Public Markets Investment Managers: Acknowledge guidelines on hire or contract renewal or amendment.

   4. Private Markets Investment Managers: Tie reporting to legal documentation; change time to meet with MCERA from annually to as needed basis.

   5. General Investment Consultant: Remove check on guidelines compliance in quarterly report; remove negotiating with private investment managers; and add assist with custodian assignment.

f. Appendix A, Long-Term Strategic Asset Allocation Targets and Ranges
   1. Change asset allocation review from monthly to quarterly.

   2. Add Opportunistic Asset Class with 0% target and range of 0.0% to 5.0%.

   3. Relax rebalancing requirement to within target range.

   4. Add Opportunistic allocations to real estate and private equity rebalancing guidelines.

g. Appendix B: For all portfolios, add "MCERA" to Performance Objectives and remove quarterly written certification of compliance to guidelines where applicable.

h. Appendix B-3: Morgan Stanley Investment Management, Non U.S. Value Equity Statement of Objectives, Guidelines & Procedures: Clarify investment approach and change notification of MCERA from 24 hours to promptly for a change in lead personnel.

i. Appendix B-14: UBS Core Real Estate Statement of Objectives, Guidelines and Procedures: (1) Add net of fees to Performance Objectives; (2) Reporting Requirements – remove monthly reports, limit quarterly reports to performance, and remove quarterly year-to-date period.

j. Appendix B-15: AEW Capital Management, Core Real Estate Statement of Objectives, Guidelines and Procedures: (1) Add net of fees to performance objectives; (2) Reporting Requirements – remove monthly reports, limit quarterly reports to performance, and remove year-to-date period.

k. Appendix B-16: CarVal Investors, Credit Value Fund V LP Statement of Objectives, Guidelines and Procedures: Add.

l. Appendix B-17: Fortress Investment Group, Fortress Credit Opportunities Funds V Expansion Statement of Objectives, Guidelines and Procedures: Add.

m. Appendix B-18: Värde Management, L.P., The Värde Dislocation Fund Statement of Objectives, Guidelines and Procedures: Add.

n. Appendix B-19: Parametric Portfolio Associates, Policy Implementation Overlay Service Statement of Objectives, Guidelines and Procedures: Reporting Requirements – remove monthly and quarterly benchmark report; remove quarterly one-, three- and five-year performance report.

o. Appendix C-1: Pathway Capital Management, Statement of Objectives, Guidelines & Procedures: (1) Add Pathway Private Equity Fund Investors 10 (PPEF I-10); (2) Performance Objectives, change Thomson/Cambridge (All Regions) All Private Equity Index to Refinitiv/Cambridge (All Regions) All Private Equity Index; (3) Investment and Other Guidelines, remove 20% limitation on General Partner’s investment in aggregate Capital Commitments; (4) Reporting Requirements, limit to Partnership legal documentation.

p. Appendix C-2: Abbott Capital Management, Statement of Objectives, Guidelines & Procedures: Add Abbott Annual Program 2021, LP (AP 2021); (2) Performance Objectives, change Thomson/Cambridge (All Regions) All Private Equity Index to Refinitiv/Cambridge (All Regions) All Private Equity Index; (3) Investment and Other Guidelines, remove 20% limitation on General Partner’s investment in aggregate Capital Commitments; (4) Reporting Requirements, limit to Partnership legal documentation.

q. Appendix D: Resolution 2010/11-03 Placement Agent Payment Disclosure Resolution and Policy: Add “or similar acknowledgement” to agreement with Placement Agent Payment Disclosure Policy and its filing, and add “or similar disclosures” to the Form 700 filing.

D. INVESTMENT CONSULTANT QUARTERLY REPORT

1. Summary Report as of March 31, 2021

Mr. Callahan reported on investment results as of March 31, 2021, the third quarter of MCERA's fiscal year. The Investment Consultant stated it has been a good year for the Fund. The rebound in equity markets continued, with a rebound in small cap and value coming back in style. International stocks continue to lag developed markets and emerging markets have been outperforming. Bonds were sharply negative during the quarter as yields rose from very low levels and global bonds benefited from the depreciation of the U.S. dollar. With inflation just starting to heat up, the Investment Consultant indicated there are concerns the Federal Open Market Committee (FOMC) may tighten monetary policy earlier than planned. Since November of 2020 sectors previously declining due to the pandemic, such as hotel resorts and cruise lines, made significant turnarounds. MCERA's private equity portfolio allocation is now at 11.5%, nearing the top end of its range, and all Fund allocations are within range of targets.

As of March 31, 2021 significant investment returns bring the value of the total Fund to a high-water mark of over $3.1 billion. The Fund returned 3.06% net of fees for the quarter and 38.70% net of fees for the last twelve months, and has outperformed on a net basis over time. The fiscal year return is about 22% net of fees for the Fund as of March 31, 2021, ahead of peers and the target return, Mr. Callahan said, and strong performance has continued in April and May.

Reporting net-of-fee returns within the Fund as of March 31, 2021 for the past twelve months, the Investment Consultant said the domestic equity return was 70.6%, driven by the 97% return of the Dimensional Fund Advisors small cap core portfolio and the 56.35% return of the State Street Global Advisors S&P 500 portfolio. International equities were up 45.30%, trailing the target return of over 50%, and the fixed income portfolio returned 7.87%, with all three managers outperforming. Real estate returns were negative 1% in that period, reflecting the struggling UBS core real estate portfolio. The public real assets portfolio returned 46.36%, driven by the significant outperformance of the two actively managed portfolios, KBI Global Resources and Invesco commodities portfolios.

Turning to private portfolios, Mr. Callahan reported the private equity portfolio is performing well. As of December 31, 2020 of the $400 million committed MCERA has paid in $362 million and received almost $85 million in distributions. The remaining Net Asset Value is $375.5 million, the Total Value to Paid In Capital is 1.82x, and the net Internal Rate of Return (IRR) is 15.33%. In the Opportunistic portfolio $20.1 million has been paid in to the Värde portfolio, which is invested in a diversified portfolio and has an IRR of 19.15%.

2. Flash Performance Update

Mr. Callahan presented fiscal year-to-date preliminary returns net of fees for the Fund as of May 31, 2021. Within the Fund outperforming sectors were domestic equity returning 45.8%, fixed income up 3% with all three managers contributing to alpha, and real assets up 40.5%. International equities returned 30.4%, underperforming the benchmark.

The Total Fund value as of May 31, 2021 is over $3.2 billion, with a 27.4% preliminary fiscal year-to-date return one month before the end of the fiscal year. Mr. Callahan advised these are extraordinary results for this period that will have a significant impact on Valuation and funding results, including the Asset/Liability Study to be discussed with the Board in the fall.

There being no further business, Chair Klein adjourned the meeting at 11:36 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