MINUTES

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

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

December 15, 2021 – 9:00 a.m.

This meeting was held via videoconference pursuant to MCERA Board of Retirement Resolution 2021/22-01, which invoked Government Code section 54953(e) for all MCERA Board and standing committee meetings through January 1, 2022. 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), Shaw (ex officio alternate), Silberstein, Tomlin, 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, introduced private credit managers CarVal Investors, Fortress Investment Group, and Värde Partners to report on the progress made to date and the environment going forward.

2. Carval Investors – Credit Value Fund V – Jody Gunderson, Matthew Hanson
TIME CERTAIN: 9:05 a.m.

Matt Hanson, a managing director for CarVal Investors responsible for global fundraising and investor relations, underscored the value of the CarVal Credit Value Fund V's multi-strategy approach in the quickly evolving private credit market. He highlighted CarVal's proven capabilities across liquid and illiquid credit and the ability to pivot in response to changing market conditions. Mr. Hanson said in 2021 investment opportunities are in illiquid credit situations across clean energy, European loan portfolios and structured credit, U.S. commercial real estate lending, emerging markets, and aviation. The common characteristic for those investment categories is that a significant portion of the return is earned from organic cash flow. Mr. Hanson introduced Jody Gunderson, one of three managing principals at CarVal and a member of the Investment Committee.

Ms. Gunderson reported employee turnover at CarVal is low. One departure in 2021 was Stuart Lammin, a principal and partner in the firm, who joined one of the portfolio companies as Chief Executive Officer. The team is investing in clean energy and building capacity in that area. CarVal is focused on improving Diversity, Ethnicity, and Inclusion as part of the fabric of the firm.

Mr. Hanson reported at its final close in May 2022 Credit Value Fund V raised $3.6 billion of capital. At five months into the three-year investment period, the net return is 14% year to date and 20% of capital has been called. Fund V is showing good diversification across four main strategies and geographically. Some of the best returns are coming from the European loan portfolio and a few corporate distress situations that are doing well. In structured credit there were opportunities during Covid at the end of 2020 and early 2021 to transact at favorable pricing. CarVal has seen a significant investment opportunity in U.S. alternative energy and small residential reperforming loans. As the economy comes out of Covid, Fund V is lending to recovering businesses in commercial real estate at conservative valuations, leading to low double-digit returns on those transactions.

Ms. Gunderson said renewable energy is an opportunity driven by the transition to clean energy that is capital intensive. Over the past five years CarVal has made significant investments in solar and wind projects, battery energy storage systems, and energy efficiency. CarVal is also lending to owners of these types of assets, so the sector is a significant growth opportunity for the firm. She noted that as credit standards are tightened, there is a capital vacuum in out of favor areas like hospitality, giving CarVal the opportunity for mezzanine financing that leads to high returns. Aviation is another stressed sector with considerable deal flow. Opportunities include buying foreclosed loans from banks and releasing aircraft, and buying aircraft directly to lease.

Noting the major recovery across the capital markets driven by fiscal stimulus and monetary policy, Ms. Gunderson explained that CarVal looks for opportunities in asset classes that lack access to capital. One was at the intersection of corporate distress and clean energy when in 2021 power grids broke down causing stress in the Texas energy market. CarVal stepped in with rescue financing to a tier one sponsor of three wind farms that were not able to deliver power, and as a result suffered financial losses. A restructuring through senior financing secured by the wind farms was underwritten to a double digit return that included an equity interest in the wind farms. In the European loan portfolio, reperforming loans that have deteriorated in credit quality from the time they were originated are acquired from banks in the private market. Then the underlying cash flows are securitized the into the liquid markets. This successful strategy led to CarVal underwriting new opportunities.

In summary, Ms. Gunderson said capturing capital markets arbitrage by acquiring illiquid loan portfolios and delivering them to the capital markets has been a favorable financing tool for CarVal. Trustee Block asked if CarVal is buying and releasing aircraft and, if so, what is the holding period. In response, Ms. Gunderson replied affirmatively and said the holding period on aircraft is typically within one year or less.

Trustee Werby asked about only 20% of commitments being called and if renewables are distressed. Ms. Gunderson replied at the moment the traded markets are expensive and low yielding, but there are signs of vulnerabilities where dislocations may unfold. The expectations is for more classic distress opportunities across various markets going forward. She explained that renewables are a capital intensive, performing strategy in which CarVal provides private debt financing to developers on an asset-backed basis.

Trustee Silberstein asked about capital call plans. Mr. Hanson replied he expects between 5% and 10% of capital to be called per quarter in 2022, resulting in between 50% and 60% of capital called by the end of 2022. He indicated it will be a steady investment period until the team sees a significant dislocation period.

3. Fortress Investment Group LLC — Joshua Pack, Danny Kayne, Matt Wittlin – TIME CERTAIN: 9:30 a.m.

Matt Wittlin, Vice President in Fortress Client Services, reported that the Fortress Credit Opportunities Fund V Expansion was formed to build on the opportunistic franchise and to invest into the Covid disruption. One year into the fund's four-year investment period, about 27% of capital has been called. In early projected returns as of June 30, 2021 the Fortress Credit Opportunities Fund V Expansion would generate a 17% net Internal Rate of Return (IRR) and a 1.5 multiple. Mr. Wittlin introduced Danny Kayne, Managing Director, and Josh Pack, one of four Managing Partners of the credit and real estate business, for the portfolio review.

Mr. Pack said generally the fund has been able to continue to invest in the post-Covid environment. While not as robust on the public side as it was 12 months ago, it is still attractive on the private debt side. As businesses are getting back on their feet, the fund is participating in opportunities with companies that were impacted by Covid. Sometimes this occurs on a pure distressed situation. As an example, Fortress took a regional cinema through a bankruptcy process, then put up new capital that allowed the cinema to succeed as the sector starts to recover. In another example a loan was transacted to fortify the balance sheet of a dental business with multiple offices that had to close. Now the business is rebounding and acquiring some of its weaker competitors. Mr. Pack said there is still disruption in the market that can be an attractive investment environment.

Outside of Covid-related transactions, Mr. Pack said, the fund is still participating in different verticals, including net lease and sale/lease-back transactions. An example is fulfilling Amazon's plans to develop and build distribution centers, which the fund will continue into 2022. Other attractive investment areas continue in legal assets, litigation finance, and intellectual property areas. In these niche areas, Fortress has the ability to create its own opportunities given its large asset management group. As a result, this is becoming a larger part of the pipeline going forward. Mr. Pack gave another example of the fund participating in the restructuring of Hertz and the new equity launch which has proved to be successful. In the transportation sector due to supply chain disruptions there are opportunities to acquire distressed loans that were secured by transportation assets in the shipping space.

In conclusion, Mr. Pack said the environment remains attractive as the private side of the market continues to open up with good investment opportunities. The strategy is to be well positioned to be able to invest capital into those situations. Over the next quarter Mr. Pack expects another 20% of capital to be called.

Trustee Gladstern asked about equity and diversity. Mr. Pack replied Fortress has created an internal committee to focus on diversity and has made a fair number of hires, both at the junior and senior level, to improve diversity.

Trustee Block asked if Fortress uses third-party managers for acquisitions. Mr. Pack replied that Fortress has over 500 employees focused on credit and about 120 employees focused on asset management. The firm takes pride in managing assets through the Fortress Asset Management group, which is a distinguishing feature of the firm. This means that in a crisis situation Fortress has the ability to stabilize situations and invest new capital. Third-party service providers, some of which are owned by the fund, are used for smaller investments. Trustee Block asked about the relationship between MCERA's management fees and the work of the General Partner. In response, Mr. Pack explained that staff is not dedicated to particular fund. The group that is working on asset management includes long-term staff members, so it is an investment expertise focus. Some expenses are applied to the fund, but the management fees generally go into funding the infrastructure and Asset Management group.

4. <u>Värde Partners – Värde Dislocation Fund – Brad Bauer, Tom Knechtel</u>
<u>TIME CERTAIN: 9:55 a.m.</u>

Tom Knechtel, Director of Business Development and Investor Relations with Värde Partners, introduced Brad Bauer, Partner and Co-Chief Investment Officer. Mr. Bauer stated that capital for the Värde Dislocation Fund was raised in June of 2020, shortly after Covid appeared. The extension to the fund ends in June 2022. Mr. Bauer reported that as of September 30, 2021, the fund was 50% drawn. The portfolio is transitioning from a largely liquid investment grade corporate portfolio into illiquid investments over the next six months. The expectation is liquid and illiquid portfolios will be more even at 50% to 60%. By June 2022 the expectation is the fund will be more than 80% drawn.

Mr. Bauer discussed top ten holdings and reviewed buy and sell metrics. He explained due to current market conditions there is not a lot of activity in pure distressed situations or restructuring transactions. The focus is on stressed and performing credit on the lending side, as opposed to being a buyer on the nonperforming side.

Mr. Bauer said within real assets there is a significant pipeline, including senior lending for hotels at growing spreads. Converting hotels into student housing in larger metro areas is one strategy. In U.S. housing, the fund is lending to developers and home builders to buy and finish homes across the southern U.S. Mr. Bauer noted over the last six months the illiquid pipeline has started to kick in. Commercial and consumer credit in the U.S. is a relatively small area that is growing. In this area the fund is a provider of capital for receivables and equipment financing, for example. Exposure to Asia on the illiquid side is building where there is structural opportunity from a lending perspective in technology firms where traditional players backed out. The fund is paid well for the risk where banks are less active and the capital markets are less developed across Australia, Singapore, Japan, and India. Another area of opportunity is in European financials that have struggled with lack of growth and an undercapitalized banking system.

In conclusion, Mr. Bauer said Värde manages risk across liquid and illiquid exposures. Investing teams are located in Asia, Europe, and in Minneapolis and New York in the United States.

Trustee Given joined the meeting at 9:55 a.m.

C. NEW BUSINESS

1. Investment Manager Personnel Updates

   a. Morgan Stanley Investment Management

   Anne Heaphy, Senior Vice President with Callan, reported Morgan Stanley recently hired Marte Borhaug as a Portfolio Manager and Head of Sustainable Outcomes with the international equity team. Ms. Borhaug will incorporate sustainability best practices into the investment process. This is fourth addition to the team this year.

   b. TimesSquare Capital Management

   At TimesSquare one of the research analysts departed for a promotion. Magnus Larsson continues as Portfolio Manager and Callan will continue to monitor staffing.

2. Watch Period Review – Callan LLC – Jim Callahan, Anne Heaphy

   a. Artisan International Growth Equity (**Action**)

   Consider and take possible action regarding Watchlist status

   The Artisan International Growth Equity portfolio still qualifies for the Watchlist based on its peer group ranking on a gross-of-fee basis for the five-year period, which is below the median. Performance for this portfolio has been strong relative to the benchmark, but the strategy is not as aggressive as other international growth managers. Callan recommends keeping the Artisan International Growth Equity portfolio on the Watchlist.

It was M/S Block/Werby to retain the Artisan International Growth Equity portfolio on the Watchlist for one more year. The motion was approved by a vote of 9-0 as follows:

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

b. Morgan Stanley International Equity (**Action**)
Consider and take possible action regarding Watchlist status

The Morgan Stanley International Equity portfolio qualifies for the Watchlist because its five-year net-of-fee return has underperformed the MSCI EAFE benchmark. Ms. Heaphy noted the portfolio is invested in high-quality companies with low volatility that generate free cash flows. In 2020 the overweight in consumer staples and health care provided downside protection in a stressed market. Callan recommends keeping the Morgan Stanley International Equity portfolio on the Watchlist.

It was M/S Silberstein/Given to retain the Morgan Stanley International Equity portfolio on the Watchlist for one more year. The motion was approved by a vote of 9-0 as follows:

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

c. Colchester Global Bonds (**Action**)
Consider and take possible action regarding Watchlist status

The Colchester Global Bond portfolio again qualifies for the Watchlist based on the five-year performance that is below the peer median. Corporate credit has outperformed which is a reason this sovereign bond portfolio is underperforming the peer group. Callan recommends adding the Colchester Global Bond portfolio on the Watchlist.

It was M/S Silberstein/Gladstern to add the Colchester Global Bond portfolio on the Watchlist for one year. The motion was approved by a vote of 9-0 as follows:

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

d. Invesco Balanced-Risk Commodities Fund (**Action**)
Consider and take possible action regarding Watchlist status

Ms. Heaphy noted in the Invesco Balanced-Risk Commodities Fund half of the risk comes from the energy sector that has been outperforming. This portfolio has broader exposure and an intentional underweight to the energy sector, which caused the underperformance. Callan recommends adding the Invesco Balanced-Risk Commodities Fund to the Watchlist.

It was M/S Silberstein/Block to add the Invesco Balanced-Risk Commodities Fund to the Watchlist for one year. The motion was approved by a vote of 9-0 as follows:

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

3. Investment Policy Statement Updates (**Action**)
Consider and take possible action on recommended amendments to Investment Policy Statement re:

Ms. Heaphy presented and reviewed the updates to the Investment Policy Statement listed below. The key update is the new emerging markets portfolio manager Fidelity Institutional Asset Management Statement of Objectives, Guidelines, and Procedures.

It was M/S Block/Silberstein to approve amendments to the Investment Policy Statement listed in Agenda Items C.3.a-e below. The motion was approved by a vote of 9-0 as follows:

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

a. General Investment Objectives and Guidelines, Fixed Income and Real Assets Portfolios: Remove "Barclays" from the applicable Bloomberg indices.

b. Appendix B-6: Replace with Fidelity Institutional Asset Management (FIAM) Select Emerging Markets Equity, Statement of Objectives, Guidelines & Procedures.

c. Appendix B-7, Wellington Management Company Core Plus Fixed Income, Statement of Objectives, Guidelines & Procedures: Remove "Barclays" from the Bloomberg U.S. Aggregate Index.

d. Appendix B-8, Western Asset Management Intermediate Credit Fixed Income, Statement of Objectives, Guidelines & Procedures: Remove "Barclays" from the Bloomberg U.S. Intermediate Credit Index.

e. Appendix B-10, BlackRock U.S. Treasury Inflation Protected Securities Fund, Statement of Objectives, Guidelines & Procedures: Remove “Barclays” from the Bloomberg U.S. TIPS Index.

D. INVESTMENT CONSULTANT QUARTERLY REPORT

1. Summary Report as of September 30, 2021

Mr. Callahan, President of Callan, presented and reviewed the quarterly Summary Report. In capital market returns as of September 30, 2021 for the trailing 12-month period, U.S. equities were up over 30% for the trailing 12 months. Non-U.S. equities slightly lagged U.S. equities for the period. In alternative investments, private real estate was up over 12% , REITs were up almost 38%, private equity returned 57%, and commodities rose nearly 43%.

For the third quarter of 2021 capital market returns were softer for several reasons: lower GDP at 2% due to supply chain issues, sentiment on the end of stimulus by the Federal Reserve, and the emergence of the Delta variance. Russell 3000 Index returns in the third quarter were relatively flat, and there was a rotation back to themes that were dominant for so long, large cap and growth equities. Non-U.S. developed equities were modestly negative. Emerging markets negative for the quarter, with China being a drag on that index. Returns for bonds were flat.

As of September 30, 2021 the Fund value was $3.35 billion. Turning to the review of MCERA’s Fund, Mr. Callahan reported on asset allocations. The Fund is slightly underweight to domestic equity, overweight to private equity, and the opportunistic portfolio is now 1% of the Fund. Based on Investment Committee action, during the quarter the large cap domestic equity portfolio was switched from the passive S&P 500 mandate to the passive Russell 1000 mandate. In addition, there was a transition from Parametric to Fidelity Institutional Asset Management for the emerging markets portfolio, and a rebalance from domestic small cap to large cap.

Trustee Silberstein asked if currency is part of the underperformance of emerging markets. Mr. Callahan replied the underperformance is partly due to the strength of the U.S. dollar. The majority of the underperformance of the emerging markets is due to stock underperformance. In response to Chair Klein’s inquiry, the Mr. Callahan said the September 30 and June 30, 2021 valuations lag for the private equity portfolio.

Reviewing Fund performance, Mr. Callahan reported modest underperformance for the third quarter. For the trailing year as of September 30, 2021, the Fund had significant outperformance of 24.5% versus its target return of 21%. The Fund ranks in the top quartile relative to the peer group of other large public pensions. These themes are consistent, as on a net basis the Fund has outperformed the target return over all longer time periods (up to 20 years). In addition, the Fund ranks in the top decile of peer groups for all periods going back 20 years.

Discussing portfolio performance for the 12-month period ending September 30, 2021, Mr. Callahan reported the domestic equity portfolio returned almost 40%, outperforming the 32% for the Russell 3000 Index on net basis. The overweight to small cap was a tailwind, as was the outperformance of the Dimensional Fund Advisors small cap core portfolio of 58.48% versus 47.5% for its benchmark. The international equity portfolio was up for the year over 19%, but underperformed the target. Parametric, due to its significant underweight to China, outperformed for the 12 months.

As of September 30,2021, trailing year and longer returns look good for the bond portfolio. For the third quarter, bonds performed in line with the target. For the 12-month period, the Wellington core plus fixed income portfolio outperformed its Bloomberg Aggregate Index. Mr. Callahan reported that intermediate credit manager Western Asset Management did an excellent job outperforming the portfolio's intermediate credit benchmark by a sizable amount over the trailing one year. The Colchester bond portfolio is sovereign only, and outperformed its index over the trailing year, but underperformed peers that have credit exposure.

The real estate portfolio returned 5% for the quarter and slightly underperformed the peer group. Retail and office sectors returns remain muted, but industrial and multifamily have performed particularly well. The AEW core real estate portfolio was slightly behind the index for the quarter, and UBS performed well for the quarter, returning over 6%. Both AEW and UBS continue to post strong income returns, but for UBS there is pressure on the depreciation side. UBS bifurcated its fund into properties to be sold and those to retain going forward. They are making modest progress on the redemption queue, which is $7.4 billion. UBS expects to have 80% of repositioning completed by the end of 2022. Mr. Callahan reported that transactions are taking place, as there is robust demand for core real estate in the marketplace.

The public real assets portfolio, consisting of actively managed natural resources and commodities and passively managed REITs and TIPS, returned 31.8% for the past 12 months, and also has strong long term performance.

In the private equity portfolio, of $450 million committed, MCERA has paid in about $380 million, with $82 million of uncalled capital. The Fund has received a total of $350 million in distributions, and there is $443 million in Net Asset Value remaining. The result is a Total Value to Paid In capital multiple of 2.1 times, and a 17.62% Internal Rate of Return (IRR).

The opportunistic portfolio is early in the process, Mr. Callahan noted. MCERA has paid in $28.5 of the $100 million committed. The portfolio has modest appreciation at this early stage, and today all three private debt managers expressed optimism regarding opportunities going forward.

2. Flash Performance Update as of November 30, 2021

Mr. Callahan presented Fund allocations and performance through November 30, 2021. Results show the same themes discussed above are playing out in the fourth quarter. As of November 30, 2021 the value of the Fund was $3.38 billion.

Trustee Block expressed concerns he has regarding risk. Indicating it feels like 1972, he cited high asset prices, an extended Fed and ample capital, and a tightening labor market. In addition, he said we are at greater risk for a supply shock, given the geopolitical issues.

He asked Mr. Callahan if we should focus on reallocating, or on a product to hedge the risk. Mr. Callahan replied those are valid risks and there are always geopolitical risks. There is also risk in decision making to try to make reactionary moves with a long-term pool of capital. Mr. Callahan stated the best risk controls are to rebalance and stay the course with respect to long term policies. There are debates on whether inflation is transitory, but the reality is there are no assets that are going to hedge against inflation over the short term, more than equities themselves. Once the Asset/Liability study is completed, Callan will be having discussions on potential asset allocation adjustments. Trustee Werby said there are hedges that would be expensive. Mr. Callahan agreed and noted the hedges can be looked at, adding the bond portfolio is a hedge by providing liquidity when needed.

There being no further business, Chair Klein adjourned the meeting at 11:09 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