

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

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

**March 16, 2022 – 9:00 a.m.**

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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 April 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 9:01 a.m.

**ROLL CALL**

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

**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. TOPIC OF GENERAL INTEREST**

### **1. Reconsideration of State of Emergency conditions under Assembly Bill (AB) 361 (ACTION)**

Reconsider and take possible action to invoke Government Code section 54953(e), and to extend MCERA Resolution 2021/22-01 Authorizing Teleconferencing for Board and Standing Committee Meetings through April 15, 2022, because the State of Emergency proclaimed under Government Code section 8625 remains in effect, and at least one of the following circumstances exists:

1. As a result of the emergency meeting in person would present imminent risks to the health or safety of attendees; or
2. State or local officials continue to impose or recommend measures to promote social distancing.

Retirement Administrator Jeff Wickman stated the Board is to consider whether conditions still exist to allow invoking Government Code section 54953(e) to extend Resolution 2021/22-01 Authorizing Teleconferencing for Board and Standing Committee Meetings for another 30 days through April 15, 2022. Mr. Wickman said this would enable the March 23 Finance and Risk Management Committee and April 13 Board meetings to be teleconferenced. Counsel Ashley Dunning advised that Senate Concurrent Resolution 5 failed in committee to rescind the State of Emergency for California, and therefore the Board could extend the ability to teleconference Board and Committee meetings for another 30 days. Mr. Wickman noted Marin County continues to strongly recommend wearing masks when indoors.

It was M/S Silberstein/Gladstern to invoke Government Code section 54953(e) and to extend MCERA Resolution 2021/22-01 Authorizing Teleconferencing for Board and Standing Committee Meetings through April 15, 2022, because the State of Emergency proclaimed under Government Code section 8625 remains in effect, and both of the circumstances listed above exist. The motion was approved by a vote of 8-1 as follows:

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

## **C. MANAGER REPORTS**

### **1. Manager Overview – Jim Callahan, Callan LLC**

Jim Callahan, President of Callan LLC, introduced Morgan Stanley, manager of the international equities portfolio, and State Street, manager of the securities lending program, to present portfolio reviews.

Due to a technical error the presenters were not available. As a result, Chair Klein directed deliberations to **Agenda Item D.1.**

## D. NEW BUSINESS

### 1. Investment Manager Personnel Update – TimesSquare Capital Management

Anne Heaphy, Senior Vice President with Callan, reported that TimesSquare Capital Management announced that David Hirsch has been named co-portfolio manager along with Magnus Larsson for the international small cap equities portfolio. Ms. Heaphy noted Mr. Hirsch has been with the strategy since its inception and stated Callan is comfortable with this change, which reduces key-person risk for the strategy.

### 2. Capital Markets Assumptions – Jim Callahan, Jay Kloepfer, Callan LLC

Mr. Callahan reported that through March 11, 2022 capital markets have reacted negatively to the Russian invasion of the Ukraine. The exception is the energy sector and commodities, which are doing well. Value is outperforming growth, and the U.S. dollar is strong versus the euro and the yen. Because of the unrest in eastern Europe, there is a reconsideration by the Federal Reserve Bank (the Fed) of how much to put on the brakes with respect to raising interest rates and reducing its balance sheet. Chair Klein asked about the steepening yield curve, which implies more tightening by the Fed. Mr. Callahan replied the expectation is for the Fed to raise interest rates multiple times in 2022, but at a slower pace than had been expected. He said higher interest rates reflect higher inflation.

The technical problems were resolved and Chair Klein paused the Capital Markets presentation and directed deliberations to **Agenda Item C.2, Morgan Stanley**.

### 2. Morgan Stanley – International Equities – Alex Gabriele, Jill Ytuarte TIME CERTAIN: 9:05 a.m.

Jill Ytuarte, Senior Portfolio Specialist with the Morgan Stanley international equity team, discussed personnel changes designed to bolster Environmental-Social-Governance (ESG) practices and sustainability objectives across investment strategies and the financial sector. She introduced Alex Gabriele, a Portfolio Manager with the international equity team, for the portfolio review.

Mr. Gabriele stated the objective for the international equity portfolio is to outperform the MSCI EAFE over a full market cycle. The strategies to generate outperformance are to invest in mispriced, high quality compounders and exploit opportunities in value stocks. The key for both strategies is to avoid fading returns and value traps, he said, adding that over time the balance between these two opportunities changes.

Mr. Gabriele reported 2021 was a strong year for developed markets in local currency, and cyclical and value sectors did well. The portfolio lagged the index due to stock selection being positioned early for a COVID reopening, after which there was a second wave of COVID lockdowns. In 2022 performance relative to the index is improving. He discussed individual companies that were affected by the slowing Chinese economy. Consumer staple stock selection detracted from performance and was related to the COVID reopening. Trustee Silberstein asked about British American Tobacco (BAT) that used to be a large holding. Mr. Gabriele replied BAT had been on a path for reduction

and has a small position in the portfolio at an attractive valuation. He spoke of the challenges BAT faces to transition to different products lines.

Chair Klein asked about the amount invested in Chinese companies, including TenCent. Mr. Gabriele said there are three companies listed in Hong Kong that are unique assets with significant opportunity. Up to 15% of the portfolio may be allocated to emerging markets. One of these is TenCent which has a strong platform that is widely in use, and which has increased in value since being acquired. Along with Chinese securities, the stock has not done well recently, but has an attractive valuation.

Trustee Silberstein asked about the engagement process with respect to executive compensation. Mr. Gabriele replied there is a systematic process on how much executives are paid and in what form. The team takes a view on whether a pay proposal is reasonable; where it is not, it will vote against management pay proposals. Morgan Stanley will seek changes to companies' compensation structures that exhibit too much discretion and not enough measurable targets; in one instance, Morgan Stanley took a position on a Board of Directors to monitor executive compensation. In another Morgan Stanley objected to there being no executive pay cuts when business was struggling. Trustee Silberstein asked if these engagements improve the financial performance of companies, and whether other investors are doing the same thing. Mr. Gabriele replied that in the long run, engagement on ESG does improve long-term performance. In particular, he said, it is important that pay is related to organic growth and operating returns. He noted that in some instances firms do not invest properly for the long term. Further, some ESG metrics are related to company reputation that is exposed on social media which can impact returns.

Portfolio positioning is overweight consumer staples, information technology, and health care, and underweight real estate, energy, utilities and materials. Revenue exposure is overweight towards North America and emerging markets. The team has a bias toward visible earnings at reasonable prices for downside protection. Since the end of 2021 there has been a shakeout from elevated price/earnings and other valuation ratios. The outlook remains cautious due to cyclically high margin levels and the prospects for higher interest rates and higher corporate taxes. In summary, Mr. Gabriele said the portfolio holds defensive companies with pricing power and recurring revenue.

Trustee Werby asked how strategy is being adjusted due to regional conflict and related sanctions. In response, Mr. Gabriele stated direct exposure to Russia is minimal and earnings will experience a small downgrade. There is a question about whether the result may be stagflation due to dislocation of supply and demand destruction for Russian goods and services. The logistical complication of servicing 3 million Ukrainian refugees is disruptive and will affect their financial status. Conditions are uncomfortable, he said, and the strategy is to be in defensive investments that have some control over managing cost, including labor inflation.

3. State Street Global Markets – Securities Lending Program – John Powell, Charles Byrne  
TIME CERTAIN: 9:35 a.m.

John Powell, Vice President and Senior Relationship Manager in State Street's Securities Finance division, reported that over 15 years the Securities Lending program has generated \$4.5 million in net revenue to MCERA. Mr. Powell said the program is in a stable pattern and experiencing an uptick in activity. In 2021 versus 2020 there was an uptick in the on-loan amount that is directly attributable to MCERA's increase in loanable assets. Lower revenue in 2021 is directly attributable to low interest rates. In 2021 the net spread was 46 basis points, which is low compared with 2020 levels. Mr. Powell explained that with expected increases in interest rates by the Fed in 2022 from zero levels, State Street will have more negotiating room for loan spreads. The expectation is to be at 2019 revenue levels for this calendar year.

Mr. Powell said the program does not lend any international assets and State Street was proactive in eliminating exposure to Russian securities one month ago. Borrowers shift month-to-month as they manage balance sheets. For securities on loan, one of the largest earners is Bed Bath and Beyond, which experienced large short positions due to COVID-based concerns. The second largest earner was GameStop, which also had large short positions. Borrowers include investors establishing short positions. Mr. Powell introduced Charles Byrne, Vice President and Senior Portfolio Manager in State Street Global Advisor's Global Cash team, to review the Compass Fund, a conservative money market fund where cash collateral at 102% of the market value on loan is invested.

Mr. Byrne, Vice President and Senior Portfolio Manager, reported in 2021 the Compass fund underperformed by 5 basis points during the 2021 downturn in money market funds as compared with 2020. With the catalyst of the first COVID-19 shutdown, the Fed dropped interest rates to zero. Slowly, through asset purchases the Fed re-liquified the market by March of 2021, leading to a flat yield curve. The median rate in 2021 was 32 basis points versus 37 basis points in 2020. Currently the yield curve is steep and credit spreads are wide as the market prices in nine interest rate hikes in 2022.

Mr. Byrne said the portfolio is well positioned to take advantage of interest rate hikes, with 75% of the portfolio having floating interest rates and 23% in fixed rates maturing within one week. This means 98% of the fund will change with the Fed's next interest rate move. Maturities will remain short term until rates move higher, and the fund is retaining more cash on hand as a buffer for any shocks due to geopolitical issues.

Chair Klein asked how State Street manages margin when loaned securities are volatile. Mr. Powell explained under these conditions there is more than enough collateral across the program to offset the exposure to one borrower.

Chair Klein recessed the meeting for a break at 10:30 a.m., reconvening the meeting at 10:40 a.m. and directing deliberations to the continuation of **Agenda Item D.2, Capital Markets Assumptions**.

Jay Kloepfer, Executive Vice President and Director of Capital Markets Research with Callan, stated capital market assumptions are developed as the cornerstone of a prudent

process to set expectations for 10 years or longer. Results need to be defensible for individual asset classes and for total portfolios, and reflect common sense and recent market developments. Mr. Kloepfer observed that since Callan began this process in September 2021 there have been interesting developments in the financial markets and the geopolitical sphere. He said capital market assumptions are biased to long-run averages and based on the belief there are risk premiums and markets will ultimately be rational.

Mr. Kloepfer reported projected 10-year returns are 6.50% for large cap U.S. equities, 8.00% for private equity, 1.75% for core fixed income, and 2.25% for inflation. Callan provides expected returns across several equity and fixed income sectors and alternative investments in its report.

Chair Klein pointed out that there had been a fundamental change in the inflation outlook reflected in the marketplace pricing as evidenced by the 10-year breakeven inflation rate published by the Federal Reserve Bank of St. Louis. She noted that the 10-year breakeven inflation rate was 2.85%, significantly higher than the 2.25% estimate used by Callan. She further noted that if Callan's estimates had been determined in September, they were in need of an update to represent the fundamental shifts in the marketplace.

Given rises in inflation in recent months, Chair Klein requested reevaluating given this inflection point. Mr. Kloepfer said he has been following interest rates closely and differed on the outlook for long-term inflation, noting the Fed's expectations have not changed. He cautioned against using the futures market for these projections, and explained the break-even rate cited is not a good predictor of long-term inflation because the first five years tends to vary according to emotion. Mr. Callahan confirmed that resetting inflation assumptions month-to-month is not something Callan does when setting long-term asset allocation strategy. Rather, Callan is setting reasonable ranges of outcomes for long-term assumptions.

Trustee Block referenced his previous remarks in the fall of 2021 about the potential for the negative real returns in the equity markets for 10 years similar to what happened in the 1970's to reappear if there is a supply shock. He thinks that capital market projections do not reflect that sanctions against buying Russian oil because of the war in the Ukraine may persist for several years and therefore tighten supply.

Mr. Kloepfer noted equity market strength in 2021 reflected by the 28.7% calendar year return of the S&P 500. He indicated that phenomenal earnings growth in 2021 is why equity markets do not look overvalued. So far in 2022 the equity market has declined and commodities have recovered. Callan reduced the Gross Domestic Product (GDP) projection to 2.25% for the U.S. over the next ten years and assumes one or two recessions in that period. Recent elevated inflation levels are not expected to persist.

### 3. Asset/Liability Study – Jay Kloepfer, Jim Callahan, Callan LLC

Mr. Kloepfer stated the purpose of the Asset/Liability Study is to establish a long-term strategic asset allocation policy based on actuarial accrued liabilities. The process integrates MCERA's investment policy with funding and benefits policies. Callan uses ProVAL valuation and projection software to build a liability model, simulate financial

conditions, and define risk tolerance and return results for defined asset mixes across major asset classes over 10 years.

Mr. Kloepfer reported that the expected return over 10 years for the current asset allocation mix assuming passive implementation is 6%. The probability of achieving the 6.75% assumed return in 10 years is 43%. The current asset allocation of the Fund is growth oriented with 62% of the Fund in global and private equity assets, which is appropriate for the long-term time horizon.

The Asset/Liability Study sets forth two sets of asset mixes that constrain real assets to 15% and decrease the fixed income allocation from 35% to 15% to increase risk. The second set of mixes changes the private equity limit to 10% of the Fund. Of five mixes, Mix 3 is similar to the Fund's current mix, and Mixes 4 and 5 have higher returns that take on more risk. Based on defined asset allocations for each mix, expected 10-year returns and risk levels are presented.

As of June 30, 2021 the Plan's funded status was 104.5%, the market value of assets were \$3.36 billion, and the actuarial accrued liabilities were \$3.2 billion. Mr. Kloepfer stated results of the Asset/Liability Study show that MCERA has a strong pension plan that is expected to retain its over 100% funded status over ten years, even with the projected 6% return. In terms of cash flow, net outflow as a percentage of assets is 2% to 3%, meaning the Plan is strong and there is no liquidity concern. In 10 years in the median case assets grow to \$4.5 billion, and actuarial accrued liabilities grow to \$4.2 billion. Mr. Kloepfer discussed how increasing portfolio risk would affect employer contributions. He also explained projections for ultimate net cost, which is the sum of cumulative contributions and the unfunded actuarial liability.

In conclusion, Mr. Kloepfer stated the current portfolio is reasonable and can be retained. He pointed out that Mix 3A and Mix 4A with the private equity target increased from 8% to 10% of the Fund are reasonable alternatives.

Chair Klein views November 2021 as an inflection point with the Federal Reserve becoming more hawkish. She said she is uncomfortable adding to private equity and prefers the current asset allocation mix. Mr. Callahan said that is a reasonable position, noting if private equity were increased by 2% for the target the investments would take from two to five years to implement. Trustee Block reiterated his concerns about recent geopolitical unrest and rising commodity prices and prefers a reassessment of the assumed return and asset positioning. Trustee Silberstein prefers no change in asset allocation. He noted that increasing commodity holdings would increase portfolio risk. He is open to reducing the assumed return over time.

Trustee Gladstern's preference is to retain the current asset allocation and see what happens going forward, because the current volatility makes it difficult to make predictions. Trustee Block said the world has changed, and the Board should not ignore what is happening globally.

Trustee Given said the world has changed but he thinks the asset allocation and assumed return should stay where they are because the Fund has a long-term investment horizon.

Before making abrupt changes, he suggested giving more time by monitoring conditions for a few months and discussing further when there is more information.

Counsel Dunning advised the assumed return is an actuarial assumption so it is critical to have the actuary's input before changing it, which could be agendaized for another meeting. The Administrator noted Callan will be putting together new capital market assumptions before the end of the year. Also, the actuary will be developing a new valuation in the fall, and another experience study is coming up which will inform whether changes are in order. Mr. Wickman stated these data will factor into the Committee's deliberations going forward. Trustee Block agreed with this assessment that it can take time to make changes. Mr. Wickman noted Callan is comfortable with the current asset allocation and no action needs to be taken.

#### 4. Future Meetings

Chair Klein invited comments on topics for future meetings.

### **E. INVESTMENT CONSULTANT QUARTERLY REPORT**

#### 1. Summary Report as of December 31, 2021

Mr. Callahan presented Callan's quarterly summary performance report as of December 2021. He reported at the end of year the Fund was modestly underweight to public equity and overweight to private equity. Other asset allocations were in line with targets. During the fourth quarter of 2021 funds were rebalanced from the domestic small cap portfolio into fixed income as a result of the Committee's decision to reduce the allocation to small cap domestic equity. In addition emerging market portfolio funds were transitioned from Parametric to Fidelity Institutional Asset Management (FIAM).

As of December 31, 2021 the Fund returned 3.57% for the 4<sup>th</sup> quarter and 16.55% for the calendar year, above target and in the top third of the peer group. During the calendar year the international equity and real assets portfolios underperformed. Over longer periods the Fund returns remain strong, with outperformance to targets and peer groups. During the 4<sup>th</sup> quarter of 2021, the domestic equity portfolio returned 9%. Large cap outperformed small cap, and the Dimensional Fund Advisors (DFA) small cap core portfolio outperformed the benchmark. The international equity portfolio returned under 1%, underperforming benchmarks for the quarter and for the last year. The fixed income portfolio had slightly negative returns for the quarter and trailing year, with the Colchester global bond portfolio experiencing a currency headwind. The Western Asset Management and Wellington Management fixed income portfolios outperformed relative to indices and have good long-term returns. The core real estate portfolio returned 5.9% for the quarter and 16% for the calendar year. AEW had a strong quarter and year, but UBS continues to struggle relative to the benchmark and peers due to retail exposure. The UBS portfolio has a significant redemption pool of \$7.4 billion, and the firm is executing on the plan with respect to distributions and reducing non-strategic assets.

In the public real asset portfolio, Invesco commodities did well in the fourth quarter, underperforming for 2021 due to being underweight energy but with a strong absolute



return. The KBI Global Investors (KBIGI) natural resources portfolio had strong returns versus the index for the quarter and year.

Private equity portfolio metrics are as of September 30, 2021. As of that date MCERA has committed a total of \$450 million and paid in 86% of that amount to the private equity program. MCERA has received distributions of \$380 million, close to the paid-in amount. Added to the Net Asset Value (NAV) of \$452 million, the total value including distributed capital is \$832 million. The ratio of Total Value to Paid-In Capital (TVPI), the key metric, is 2.15x, and the net Internal Rate of Return (IRR) is almost 18%. Abbott Capital Management and Pathway Capital Management manage the two private equity portfolios.

CarVal Investors, Fortress, and Värde manage equal portions of the opportunistic portfolio. MCERA has paid in \$34.6 million of \$100 million committed, and in early stages of the investment process the net IRR is 14.7%.

## 2. Flash Performance Update as of February 28, 2022

Mr. Callahan presented the performance update as of February 28, 2022. He reported since January 2022 the equity markets sold off, so most portfolio returns were negative for those two months. The DFA domestic core small cap portfolio continues to perform well in relative terms versus its benchmark. MCERA's domestic large cap equity portfolio tracks the Russell 1000 Index. International equity continues to underperform as Artisan and TimesSquare portfolios have a growth orientation which is underperforming value. The FIAM emerging markets portfolio modestly underperformed the benchmark.

In the fixed income portfolio negative returns continued, though Colchester global bonds outperformed its benchmark so far this year. The public real assets portfolio return is negative; Invesco commodities had a strong positive absolute return, but underperformed the index due to the underweight to energy. This underweight also affected the KBIGI natural resources portfolio return relative to the related index. The passively managed Treasury Inflation-Protected Securities (TIPs) and REIT portfolios are in line with benchmarks. Through February the Fund was down about 4.5% for 2022, and the fiscal year-to-date return was slightly negative.

Trustees Poirier, Werby and Gladstern were excused from the meeting at 12:43 p.m., 12:45 p.m., and 12:50 p.m., respectively.

Mr. Wickman invited Trustee Roy Given to address the Committee/Board. Mr. Given announced his retirement from the County of Marin effective March 31, 2022. This will be his last meeting as the Ex Officio Member on the Board of Retirement. Mr. Given thanked Board members for their service. He added their time and effort shows they care, and it has been an honor to work together. On handling the Fund, he said what is needed is to give time to consider the best decision. Interim Director of Finance Mina Martinovich will take over as the Ex Officio Member. Trustee Murphy thanked Mr. Given for the help he provided to her, and Trustee Block congratulated Mr. Given on his retirement and for lending his perspective and financial acumen. Board Chair Silberstein said it has been a pleasure working together and noted the Fund is in good shape. Chair Klein observed Mr. Given is a dedicated public servant and she appreciates

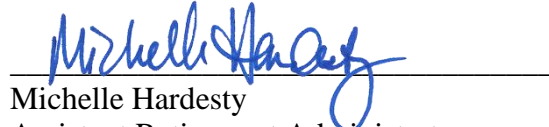
his good nature, and Trustee Jones congratulated Mr. Given on his retirement and appreciates working with him for many years.

Mr. Wickman said he has been fortunate to work with Mr. Given as a boss and a peer. He stated that Mr. Given has always provided good advice on how to navigate County government and manage the operations of the retirement system. Mr. Wickman thanked Mr. Given for his patience and confidence in him.

There being no further business, Chair Klein adjourned the meeting at 1:11 p.m.



Jeff Wickman  
Retirement Administrator



Michelle Hardesty  
Assistant Retirement Administrator

On behalf of:  
Sara Klein, Investment Committee Chair

On behalf of:  
Jeff Wickman, Retirement Administrator