# MINUTES

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

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

**September 28 , 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 October 14, 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 9:00 a.m.

### ROLL CALL

PRESENT: Cooper, Gladstern, Klein, Murphy, Silberstein, Tomlin, Vasquez, Werby, Jones (alternate retired), Shaw (ex officio alternate)

ABSENT: Martinovich, Poirier (alternate safety)

### A. OPEN TIME FOR PUBLIC EXPRESSION

Note: The public may also address the Committee regarding any agenda item when the Committee considers the item.

Open time for public expression, from three to five minutes per speaker, on items not on the Committee Agenda. While members of the public are welcome to address the Committee during this time on matters within the Committee's jurisdiction, except as otherwise permitted by the Ralph M. Brown Act (Government Code Sections 54950 et seq.), no deliberation or action may be taken by the Committee concerning a non-agenda item. Members of the Committee may (1) briefly respond to statements made or questions posed by persons addressing the Committee, (2) ask a question for clarification, or (3) provide a reference to staff for factual information.

No members of the public provided comment.

### B. MANAGER REPORTS

1. Manager Overview – Jim Callahan, Callan LLC

   Jim Callahan, President of Callan LLC, introduced private equity managers Abbott Capital Management and Pathway Capital Management. Mr. Callahan stated the private equity allocation is targeted at 8% of the Fund.

2. <u>Abbott Capital Management – Private Equity – Leonard Pangburn, Jonathan Roth, Sean Long – TIME CERTAIN 9:05 a.m.</u>

Jonathan Roth, Managing Director and Co-President of Abbott Capital Management, reported he would transition from his current role to Executive Advisor next year. In support of this transition Leonard Pangburn, Managing Director, was named Co-President of Abbott Capital Management effective October 2021. Mr. Roth introduced Sean Long who rejoined the investment team in August 2022 in a marketing capacity. Mr. Pangburn stated Abbott's investment process employs a collaborative approach and begins with sourcing high-quality General Partners. This is followed by investment and operational due diligence and then conviction-building based on future performance potential. Investments include primaries, secondaries and co-investments.

Mr. Roth reviewed key metrics for MCERA's private equity portfolio as of March 31, 2022. Of $225 million committed since inception in 2008, $201 million has been called. Over that period $211.2 million has been distributed to MCERA and the remaining value is $200.8, for a total value of $412 million and a net Internal Rate of Return of 17.0%. Mr. Roth reviewed MCERA's overall performance, noting returns outpace the broad public equity markets. Chair Klein asked what distributions are expected to be in the 12 months following August 31, 2022. Mr. Roth estimated $20 million as a conservative value of distributions for that period and $40 to $60 million as a less conservative estimate. Asked by Chair Klein what strategies would be used to realize those distributions, Mr. Roth said private-to-private transactions, such as with buyout funds or recapitalizing growth equity, would be employed.

Turning to individual funds, Mr. Roth stated ACE VI had strong distributions as of March 31, 2022 and a 2.0x net Total Value to Paid-In ratio (TVPI) as of September 2022. Chair Klein asked about the life of ACE VI which Mr. Roth said is a 12-year fund that has been extended through March of 2023. He explained that the remaining value in ACE VI, mostly venture capital and growth equity investments, is due to the lag in new commitments in its early stages. To liquidate ACE VI, Abbott may use secondaries to provide capital for distributions, Mr. Roth said. Chair Klein asked if declines in public equities affect private equity valuations. In response Mr. Roth reviewed holdings he termed exceptions that will hold value, acknowledging there is some effect on private equity valuations but not as much as with public equities.

Mr. Roth reported ACE VII has generated a 31.1% IRR and is one of the best performing funds. For the year ending March 31, 2022 distributions to MCERA were over 45% of the fund value, resulting in a 2.5x net TVPI ratio. Remaining value in ACE VII is more balanced between the Buyout/Special Situations and Venture Capital strategies.

Mr. Long explained that Abbott reoriented the private equity platform to the Annual Program (AP) in 2015. MCERA invested in AP 2016 which Mr. Pangburn reported has distributed 40% of capital and is benefiting from secondaries. Many of this fund's strategies have IRR's over 20%, ranging from 19.2% to 42.4%.

Mr. Pangburn reported AP 2017 has 85% of capital called as of March 31, 2022. Small Buyouts were added to its strategies, and TVPI ratios range from 1.4x to 2.0x. AP 2017 is expected to be fully cash flow positive in 2023. AP 2021 is still developing and is in its investment period, with 22% of committed capital called. Due to secondaries, AP 2021 is through the J-Curve.

Trustee Werby asked about the overall size of assets managed by Abbott. In response Mr. Roth said the Abbott team manages just under $15 billion and is mindful of capacity when pacing new investments. Trustee Vasquez noted public market price/earnings multiples are going down and private equity is predicated on public market valuations. Given that rising interest rates are used to discount cash flows to determine valuations, he asked what the thinking is about these compressing forces. Mr. Pangburn replied that the valuation approach is bottom up and Abbott is not trying to time the markets. The underlying investments will be held for 3 to 5 years over varying market cycles, he said. Mr. Pangburn further stated in terms of credit the focus is on middle market funds and credit is not relevant for some investments.

3. <u>Pathway Capital Management – Private Equity – Jim Reinhardt, Valerie Ruddick TIME CERTAIN: 9:35 a.m.</u>

Valerie Ruddick, Managing Director with Pathway Capital Management, introduced Bryan Nelson, Director and Partner. Ms. Ruddick reported MCERA has committed $225 million to Pathway funds since 2008. As of March 31, 2022 contributions to date are $198 million and total portfolio value is $436 million, which is 2.2x the capital contributed. Distributions to date are $221 million. The Total Value to Paid-In ratio (TVPI) across all funds averages 2.2x, and the net Internal Rate of Return (IRR) compounded annually across the portfolio since inception is 17.5%.

Mr. Nelson reviewed performance across strategies, geographic region, and investment type. Strategies are Buyouts, Venture Capital and Special Situations. In 2017 MCERA's portfolio became cash flow positive, and in 2021 a record $75 million was distributed to MCERA. Mr. Nelson pointed out that in 2021 the market value of the portfolio peaked at $230 million and is expected to tail off in the future without new commitments. In conclusion, Mr. Nelson said performance is good on both an absolute and comparative basis.

Chair Klein asked what distributions are expected in the 12 months following August 2022. Mr. Nelson replied that distributions in that period are likely to be in the $20 to $30 million range, and more or less depending on market conditions. Chair Klein inquired about the confidence level for valuations in venture capital and growth equity portfolios. In response, Ms. Ruddick said valuations for the June and September quarters of 2022 are expected to decline. Noting valuation depends on the life stage of the investment, Ms. Ruddick said managers tend to be conservative in valuations relative to the expected exit.

Chair Klein asked about PPEF 2008 which has its 15$^{th}$ anniversary in December 2023. Ms. Ruddick replied the portfolio holdings remaining in PPEF 2008 are winding down, and Pathway is proactive in encouraging managers to exit fund investments. Trustee Werby asked if fees will increase and Ms. Ruddick reported for PPEF I-11 carried interest is being introduced on co-investments and secondaries. She said the management fee has been reduced to 49 basis points, but overall fees will be higher assuming Pathway meets return objectives. Trustee Werby asked about the amount Pathway plans to invest each year without sacrificing quality. Ms. Ruddick replied Pathway is aiming to invest $6 billion per year across primaries, secondaries and co-investments. She said that deal flow continues to impress and there is sufficient capacity within the forward pipeline to invest.

**C. NEW BUSINESS**

1. Private Equity Annual Review and Pacing Plan (ACTION)
   Consider, discuss and take possible action regarding private equity pacing plan

   Gary Robertson, Callan Private Equity Consulting, reported the private equity portfolio is at 13.7% of the Fund versus its 8% target. Mr. Robertson stated because it continues to liquidate, managers are now out of capital to invest. As a result, Callan is recommending adding new commitments to support the private equity program diversification across market cycles. Mr. Robertson reported markets are becoming less liquid but generally private equity remains popular with investors.

   In the twelve months prior to March 31, 2022 MCERA paid in $30 million to the private equity program and has $65 million in uncalled capital remaining. This was a liquid period, with $126 million in distributions to MCERA representing about 33% of the portfolio Net Asset Value (NAV). The private equity program rose in value 21.1% and the Total Value to Paid-In ratio (TVPI) was 2.13x.

   Mr. Robertson stated Callan recommends committing up to $60 million to the private equity program this year. He presented a 10-year projection of capital commitments to maintain the 8% private equity allocation. Chair Klein noted Callan's projected distributions for the next year are higher at $114 million than the managers' estimates of $40 million, and Mr. Robertson agreed the timing of those projections may be longer. He pointed out that new commitments will be invested over a period of several years and emphasized the importance of investing consistently across vintage years.

   Responding to Trustee Werby's inquiry on how higher interest rates affect valuations, Mr. Callahan noted the increase in the cost of capital affects all equity investments. He further stated that private equity is still expected to return a premium over public equity over time. Chair Klein invited further comments. Trustee Vasquez said the cost of capital is a competitive advantage of the asset class itself, and is therefore a headwind as the cost rises. He said for future commitments understanding what strategies will use leverage and if there is leverage embedded in existing portfolios is important. In response, Mr. Robertson said general partners have used less leverage as interest rates have risen, and operational experts make sure value is created through growth rather than leverage. Trustee Gladstern asked about Callan's recommendation for this year's commitments, which Mr. Robertson said is up to $30 million for each manager. Mr. Callahan added a smaller amount would be reasonable.

It was M/S Gladstern/Cooper to invest $25 million each in the Abbott Capital Management and Pathway Capital Management private equity portfolios.

Chair Klein stated she could not support the motion based on the value of the total Fund and the asset allocation plan that is significantly over the target for private equity. If market conditions deteriorate, she is concerned assets will need to be sold in order to meet private equity capital calls. In a rising interest rate environment, Chair Klein prefers to stay liquid as the most prudent path.

In response to Trustee Werby's inquiry on the pacing plan model, Mr. Callahan said the pacing plan is a discipline to allocate capital in a prudent way by vintage year over time. Mr. Robertson added that funding the private equity program is not a liquidity issue.

The motion was approved by a vote of 6-3 as follows:

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| AYES: | Cooper, Gladstern, Murphy, Silberstein, Tomlin, Werby |
| NOES: | Klein, Shaw, Vasquez |
| ABSTAIN: | None |
| ABSENT: | Martinovich |

2. Private Equity Annual Fee Disclosure (ACTION)
   Consider, discuss and take possible action regarding private equity fee disclosure

   Mr. Robertson presented the Private Equity Annual Fee Disclosure. In 2021 manager fees and carried interest for the Abbott private equity portfolio were $1.5 million and for Pathway, $1.3 million, totaling $2.8 million. Adding total expenses of $268,000 results in $3.1 million in total Fund-of-Funds manager fees and expenses for the 2021 calendar year. In addition, underlying partnership fees for Abbott were $28 million and $35 million for Pathway, totaling $63 million. Total Fund-of-Funds and underlying partnership fees and expenses for 2021 were $66 million. Since inception total Fund-of-Funds manager fees and expenses are $31.6 million and underlying partnership data is incomplete. Mr. Wickman explained this report is required to be presented annually and must be adopted by the Board. Once adopted, the report will be posted to MCERA's web site.

It was M/S Werby/Silberstein to adopt the Private Equity Annual Fee Disclosure as presented. The motion was approved by a vote of 9-0 as follows:

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| AYES: | Cooper, Gladstern, Klein, Murphy, Shaw, Silberstein, Tomlin, Vasquez, Werby |
| NOES: | None |
| ABSTAIN: | None |
| ABSENT: | Martinovich |

3. Fixed Income Structure (ACTION) – Jim Callahan, Callan LLC
   Consider and take possible action regarding reallocation of fixed income structure

   Mr. Callahan reviewed alternative structures for the fixed income portfolio as a follow up to discussions at the June 15, 2022 Investment Committee meeting. Currently, the fixed income portfolio is targeted at 23% of the Fund and consists of 50% U.S. Core Plus managed by Wellington Management Company, 25% U.S. Intermediate Credit managed by Western Asset Management Company, and 25% Global Fixed Income managed by Colchester Global Investors. Mr. Callahan said the structure was adopted by the Investment Committee in 2014 to diversify from the sole active core plus mandate and secondly to reduce interest rate sensitivity. He also noted the current structure remains a sound alternative.

Mr. Callahan reported in 2022 the benchmark Bloomberg U.S. Aggregate Bond index has declined over 15% in a short period of time due to the headwind of rising interest rates from extremely low levels. In addition, the Bloomberg Global Aggregate Bond index is down almost 21% year to date, due in part to the strength of the U.S. dollar. As a result, the non-dollar portfolio is challenged and has been a key headwind to the fixed income portfolio.

Mr. Callahan presented three alternative fixed income allocations. Objectives are to maintain diversification and income as primary elements of the fixed income portfolio.

Alternative fixed income structures are:

1. 50/50 Core Plus, managed by Wellington and Western Asset
2. 50 Core Plus/50 Intermediate Credit, managed respectively by Wellington and Western
3. 60 Core Plus/40 Intermediate Credit, managed respectively by Wellington and Western

Mr. Callahan reviewed the effects of each strategy on yield, fees, credit quality, correlation with equity, tracking error, duration and Sharpe Ratio. He noted Intermediate Credit lowers duration, thus lowering interest rate risk, and increases credit risk. All three alternative mixes would have lower fees, higher yields, and higher Sharpe Ratios than the current portfolio.

Chair Klein prefers the 50/50 Core Plus as a reasonable fixed income allocation based on lower fees and higher Sharpe Ratio. Mr. Callahan supported this allocation due to yield, lower fees and less correlation to equities.

It was M/S Silberstein/Murphy to adopt a 50/50 Core Plus fixed income allocation with Wellington Management Company LLP and Western Asset Management Company as managers, terminating Colchester Global Investors.

Mr. Callahan presented a research note that is supportive of Western Asset as a Core Plus fixed income manager. Trustee Gladstern asked about the difference between Intermediate Credit and Core Plus. In response Mr. Callahan explained Core Plus is a broader mandate with latitude to invest in non-benchmark securities. He said the Committee could consider other managers for the Core Plus mandate. As a point of clarification, the Administrator suggested including the status of managers in the motion and Trustees Silberstein and Murphy modified the motion accordingly.

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

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|---|---|
| AYES: | Cooper, Gladstern, Klein, Murphy, Shaw, Silberstein, Tomlin, Vasquez, Werby |
| NOES: | None |
| ABSTAIN: | None |

ABSENT: Martinovich

4. UBS Trumbull Property Fund GP LLC Restructuring
   Consider and discuss Regulatory Conversion of the Trumbull Property Fund

   Anne Heaphy, Senior Vice President with Callan, reported the Trumbull Property Fund is changing its legal and governance structure due to regulatory requirements. Under the new structure a Board of Directors will oversee the Fund which will have a regulatory life of 15 years. Ms. Heaphy said Callan supports the UBS request to ratify the new structure, noting it is not uncommon to have a Board of Directors for an open-ended real estate fund.

   In response to Trustee Werby's inquiry, Ms. Heaphy said director fees and expenses will be paid by the Fund. In the absence of objections, Mr. Wickman said he would execute the ratification.

5. Future Meetings

   Chair Klein asked if there is a requirement to return to in-person meetings. In response, Counsel Dunning explained that currently the Board is operating under the California State of Emergency conditions allowing for videoconferencing Board and Committee meetings. Ms. Dunning said a provision has been made when operating under normal Brown Act conditions to permit Board members to be absent occasionally during in-person meetings under certain conditions.

**D. INVESTMENT CONSULTANT QUARTERLY REPORT**

1. Summary Report as of June 30, 2022

   Ms. Heaphy discussed the Summary Report for the quarter ending June 30, 2022. Ms. Heaphy reported during the quarter both stocks and bonds reacted to rising interest rates, the war in Ukraine, and global economic weakness. U.S. large cap stocks declined 16% and small cap stocks declined 17% during the quarter. Over one year, U.S. large cap stocks were down 10.6% and small caps declined over 25%. In U.S. equities value outperformed growth for the quarter and prior 12 months. Fixed income markets were also negative, with the Bloomberg Aggregate Bond index down 4.7% for the quarter and down 10.3% for the prior 12 months. Real estate rose 5.3% for the quarter and returned nearly 24% for the prior 12 months. Commodities were down about 5.7% in the quarter but returned 24.3% for the prior 12 months.

   As of June 30, 2022 the total Fund value was just over $3 billion and the preliminary total Fund return was negative 9% for the 12 month period. As compared with peers the Fund is performing in the top quartile. There are no changes to the Watchlist which the Committee will review at its December meeting.

   In the domestic equity portfolio, Dimensional Fund Advisors (DFA) small cap core is outperforming the benchmark due to its value tilt. The international equity portfolio slightly outperformed the benchmark for the quarter and underperformed the benchmark over the past year due to the growth orientation of the Artisan and TimesSquare portfolios. Western Asset and Wellington fixed income portfolios slightly underperformed benchmarks for the quarter and year due to having more credit exposure. The Colchester global fixed income portfolio was down 16.7% for the prior 12 months. The real estate portfolio had positive returns for the quarter and prior 12 months. The AEW Core Property Trust rose over 3% for the quarter and over 27% for the prior 12 months. The UBS Trumbull Property Fund returned 3.84% for the quarter and almost 24% for the prior 12 months. Ms. Heaphy noted UBS is repositioning its fund to increase the industrial exposure. In the real assets portfolio, Invesco commodities had good relative performance in the quarter. Strategic underweights to the traditional energy sector caused commodities and natural resources to underperform benchmarks over the prior 12 months.

Chair Klein expressed disappointment that real assets are not providing inflation protection. Mr. Callahan explained there is little to invest in to protect from short-term rises in inflation. He pointed out that Treasury Inflation-Protected Securities (TIPS) also have duration risk.

2. Flash Performance Update as of August 31, 2022

Ms. Heaphy presented the Flash Performance Update as of August 31, 2022. The total Fund Value was $3.08 billion, returning net 1.6% for the fiscal year to date and negative 11.6% for the calendar year to date. The domestic equity portfolio slightly outperformed the benchmark for the fiscal and calendar years to date and international equities underperformed in those periods.

There being no further business, Chair Klein adjourned the meeting at 12:48 p.m.

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| ______________________________ | ______________________________ |
| Jeff Wickman | Michelle Hardesty |
| Retirement Administrator | Assistant Retirement Administrator |
| | |
| On behalf of: | On behalf of: |
| Sara Klein, Investment Committee Chair | Jeff Wickman, Retirement Administrator |