

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

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

December 7, 2022 – 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 December 30, 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: Cooper, Gladstern, Klein, Murphy, Silberstein, Tomlin, Vasquez, Werby, Gullett (alternate safety), Jones (alternate retired), Shaw (ex officio alternate)

ABSENT: Martinovich

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 manager UBS for the review of the Trumbull Property Fund, one of two open-ended core real estate funds in MCERA's Fund.

2. UBS – Trumbull Property Fund – Paul Canning, Tom O’Shea
TIME CERTAIN: 9:05 a.m.

Tom O’Shea, Head of the UBS Portfolio and Client Service group, introduced Paul Canning, Senior Portfolio Manager of the Trumbull Property Fund (TPF). Mr. Canning began the review with portfolio positioning as of September 30, 2022. He reported the most significant allocation is to the Apartment sector due to steady demand characteristics and low capital requirements. The second largest allocation is the Industrial sector which matches the index. Mr. Canning stated UBS continues to trim the Office sector in favor of the significant expansion of the Self-Storage properties.

Mr. Canning said after a period of meaningful underperformance to the NFI-ODCE benchmark following the financial crisis, UBS revised the investment strategy for the Trumbull Property Fund. In 2020 a non-strategic portfolio was identified to provide liquidity for redemption requests and while the remainder of the TPF was repositioned for the long term. Since the repositioning Mr. Canning noted the dispersion of returns in commercial real estate, with the Industrial and Multi-Family sectors outperforming other sectors. He said the demand characteristics of these two sectors continues to be positive.

In the non-strategic portfolio 44 properties were identified for disposition; of these, 77% have been divested, mostly through individual sales. Transaction activity shows the active management employed to increase allocations to the West Coast and to the Industrial sector. Core real estate has evolved to include specific initiatives such as Self-Storage due to its low capital requirements and steady income. Within Industrial there is a sub-focus on cold storage due to growing demand. In the Office sector TPF is increasing the allocation to life sciences spaces. This may involve converting traditional office buildings to life science use in the main markets for these buildings.

Leverage for TPF is under 18% and under the benchmark due to near-term declining real estate values. In January 2021 the redemption pool balance was \$8.2 billion. Since then TPF has funded \$3.3 billion for that pool that was offset by increased redemption requests. As of November 1, 2022 the redemption pool balance is \$7.2 billion.

In conclusion, Mr. Canning said the new Independent Board of Trustees is a positive improvement in TPF governance and will be an important strategic resource in deploying investor capital. Moving forward, headwinds include the increased cost of debt, the conservative position of the banking system, and recession concerns. As a result, many equity investors in commercial real estate have moved to the sidelines and transaction activity is down significantly. This is expected to result in lower valuations in the near term.

Trustee Werby noted over the past three years income has been much less than the appreciation portion of performance and asked about Mr. Canning’s confidence in appraisals. In response, Mr. Canning said the appreciation gains over the past two years came from significant increases in income at the property level across the portfolio and commercial real estate valuations. At the beginning of 2022 the 10-year yield was relatively low, leading to higher valuations. Mr. Canning said every property is appraised quarterly by third-party appraisers and rolled up into the Net Asset Value (NAV) of TPF.

Third quarter results show depreciation due to lower real estate values, which Mr. Canning expects to continue into the 4th quarter.

Trustee Silberstein asked if there is backup power for the cold storage facility in Texas. Mr. Canning replied the facility has an emergency generator. Trustee Gladstern asked about the breakdown of the Industrial sector. Mr. Canning replied Industrial subcategories include dry warehousing, which is 95% of Industrials in the current portfolio. A second type of Industrial property is flex buildings that are a combination of office and distribution space. Demand for industrial space includes the shift to direct-to-consumer service, using smaller locations closer to consumers.

Chair Klein asked about capitalization (cap) rates and borrowing costs. Mr. Canning said at the end of the 3rd quarter of 2022 the average cap rate was 3.6%. For an apartment building the cap rate would range between 4% and 5.25%, and the borrowing cost would be between 5 and 6%. Mr. Canning pointed to considering the potential growth in net operating income over the long run when valuing property. Asked by Chair Klein if news about large redemption requests from REITs would affect TPF, Mr. Canning said there would be no impact on TPF because the set of investors is different.

Trustee Silberstein asked when the non-strategic portfolio will be liquidated. In response Mr. Canning said the non-strategic remaining value as of the 3rd quarter of 2022 is less than \$1 million, so most assets have been disposed. To address the redemption pool the plan includes some downsizing of TPF, attracting new capital, and attrition of some investors' redemption requests.

C. NEW BUSINESS

1. Watch Period Review – Callan LLC – Jim Callahan, Anne Heaphy
 - a. Artisan International Growth Equity (ACTION)
Consider and take possible action regarding Watchlist status

Mr. Callahan said the Artisan International Growth Equity fund is on the Watchlist because its ranking for the trailing 3-year period as of September 30, 2022 is in the 94% percentile for non-U.S. growth oriented managers. In addition, calendar year performance was poor in 2015 and 2016. Subsequently, performance has improved and its ranking is above the median, but performance still trails the benchmark. Mr. Callahan said that, qualitatively, there are no changes to the investment team or philosophy. In 2022 a reversal in relative performance from growth to value was triggered by the Ukraine war and rising inflation. Most sectors have had negative performance, except for energy. Callan is comfortable with Artisan for the long term, in part due to the stable management team, Mr. Callahan said.

Trustee Vasquez asked if rising strength in the dollar affects performance for Artisan. Mr. Callahan replied that the U.S. dollar has been strong through the 3rd quarter of 2022, which is a headwind for international investments. He pointed out many Artisan holdings are large companies with diversified sources of income, whose financial officers sometimes hedge revenues.

Chair Klein observed that the Artisan portfolio has low 3-year net returns relative to peers and has been on the Watchlist for several years. She also pointed out that according to the Investment Policy Statement, managers are to rank in the top half of peers. Mr. Callahan said the manager can be changed, but he pointed out that what happened in 2020 affects the 3-year return significantly and the portfolio has been performing better near term. He said manager performance is cyclical and over the long term the Artisan strategy has been successful and has added value, outperforming the benchmark since inception.

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

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

Trustee Gullett was excused from the meeting at 10:28 a.m.

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

Mr. Callahan said compared with peers the Morgan Stanley International Equity portfolio has a quality story, focusing on value in companies with strong fundamentals. Turnover on the investment team has stabilized, and William Lock, the lead portfolio manager and key architect of the strategy, remains in place. Calendar year performance in 2016 was poor versus peers, followed by four years of good performance. The portfolio struggled again in 2021 and 2022 due to an underweight to energy. Another headwind this year was the overweight to consumer staples and to technology. Mr. Callahan said from a qualitative standpoint Callan remains confident in Morgan Stanley.

Trustee Vasquez said the structure of the asset class will present more challenges in international investing. He added that the yellow flag is how long managers have been on the Watchlist, and suggested a more involved conversation is in order about manager selection and the structural headwinds of international investing. Chair Klein and Trustee Silberstein supported his view.

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

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

- c. Invesco Balanced-Risk Commodities Fund (ACTION)
Consider and take possible action regarding Watchlist status

Mr. Callahan stated the Invesco Balanced-Risk Commodities Fund in the real asset portfolio uses a thoughtful, balanced-risk approach to commodities in the index. Its underweight to oil and natural gas has resulted in underperformance to the index. Callan remains comfortable with the strategy and recommends retaining the portfolio on the Watchlist. Trustee Werby noted the sector has negative returns over the long term. Mr. Callahan said the portfolio has a good 3-year return, adding that commodities are volatile and serve as a diversifier to other real assets.

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

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

Trustee Cooper was excused from the meeting at 11:00 a.m.

2. Investment Policy Statement Updates (ACTION)

Consider and take possible action on recommended amendments to Investment Policy Statement re:

Anne Heaphy, Senior Vice President with Callan, presented updates to the Investment Policy Statement, most of which relate to the recent change in the fixed income portfolio. The Western Asset Management Co. strategy has been moved to core plus from its prior intermediate credit strategy, and the Colchester Global Investors Global Bond portfolio has been removed. Updates also reflect new private equity commitments. Chair Klein requested that Supranationals be spelled out in the Western Asset guidelines.

Trustee Vasquez asked about the use of leverage in derivatives. Mr. Callahan explained in the Investment Policy Statement derivatives are allowed if they are in the individual manager guidelines and not used for leverage. Derivatives are predominantly exchange-traded and are used to control risk and provide liquidity. Trustee Werby asked about the edit to remove the Investment Committee. After reviewing this edit, Mr. Wickman said the reference to the Investment Committee should be reinstated.

It was M/S Werby/Silberstein to approve updates to the Investment Policy Statement listed in Items C.2.a-f below, to include spelling out Supranationals in the Western Asset Statement of Objectives and removing the deletion of the Investment Committee. The motion was approved by a vote of 8-0 as follows:

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

- a. General Investment Objectives and Guidelines, Fixed Income Portfolios: Add Bloomberg U.S. Aggregate Bond Index and remove Blended Benchmark, Bloomberg U.S. Intermediate Credit Index and FTSE World Government Bond Index.
 - b. Appendix A, Long-term Strategic Asset Allocation Targets and Ranges, Fixed Income: Adjust U.S. Core Plus Fixed Income to match the fixed income allocation and remove U.S. Intermediate Credit and Global Fixed Income categories.
 - c. Appendix B-8, Western Asset Management Statement of Objectives, Guidelines and Procedures: Revise to reflect new strategy of core plus fixed income.
 - d. Appendix B-9, Colchester Global Investors Statement of Objectives, Guidelines, and Procedures: Remove.
 - e. Appendix C-1, Pathway Capital Management Statement of Objectives, Guidelines and Procedures: Add Pathway Private Equity Fund Investors 11.
 - f. Appendix C-2, Abbott Capital Management Statement of Objectives, Guidelines and Procedures: Add Abbott Annual Program 2023, LP.
3. Future Meetings

No discussion of future meetings.

D. INVESTMENT CONSULTANT QUARTERLY REPORT

1. Summary Report as of September 30, 2022

Mr. Callahan reported equity markets had negative returns through the third quarter of 2022. In the U.S. equity markets, value managers have outperformed growth, and energy has performed well. International markets were down and currency has been a headwind. Fixed income markets are down year to date as yields have risen. Mr. Callahan noted the yield curve has been inverted, which tends to be a precursor of recession. Real estate values are beginning to depreciate, and in the latest quarter returns for private equity are negative.

Ms. Heaphy reported the Total Fund market value is just over \$2.8 billion as of September 30, 2022. For the quarter the Fund was down 4.64% net of fees and down 14.75% net of fees for the last twelve months. The Fund performance is favorable versus peers over the long term. For the fiscal year to date the Fund is down 4.64% net of fees.

In the 12 months ending September 30, 2022, the domestic equity portfolio consisting of 75% S&P 500 Index and 25% DFA small cap core equity outperformed the Russell 3000 due to DFA's value orientation. In the international portfolio, TimesSquare has a high quality growth tilt that was a headwind to performance. The Fidelity emerging markets portfolio trailed over the last quarter and 12 months due to exposure to Chinese holdings in technology and healthcare.

The fixed income portfolio had a challenging 12-month period. In mid-November assets were transferred to Western Asset to reposition its portfolio to the core plus strategy. In the real estate portfolio, the UBS Trumbull Property Fund is 97% leased, shows strength

in Industrials and Multi-Family, and has 80% of loans at fixed rates. In the real assets portfolio, the Invesco commodities structural underweight to the traditional energy sector was a headwind. The lack of exposure to this sector hindered the KBI natural resources portfolio performance.

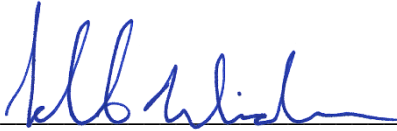
In the private equity program as of June 30, 2022 89% of committed capital has been paid in. The Total Value to Paid-In (TVPI) capital ratio was 2.04x, and the net Internal Rate of Return was 16.32%. In the early-stage Opportunistic portfolio as of September 30, 2022, of \$100 million committed to managers CarVal, Fortress, and Varde, \$53 million is paid in.

a. Flash Performance Update as of October 31, 2022

Ms. Heaphy presented a performance update for the Fund as of October 31, 2022. She explained that fixed income, private equity, and real estate returns are preliminary.

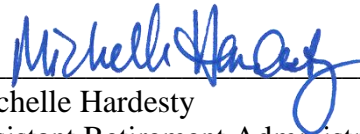
Mr. Wickman clarified a modification to proposed updates in the Investment Policy Statement in Agenda Item C.2 above.

There being no further business, Chair Klein adjourned the meeting at 11:28 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