

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

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

March 29, 2023 – 9:00 a.m.

This meeting was held at the address listed above and was accessible via videoconference and conducted in accordance with Government Code section 54953 and 54954.2 through December 31, 2025.

CALL TO ORDER

Chair Klein called the meeting to order at 9:03 a.m.

ROLL CALL

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

ABSENT: None

CONSIDER ANY BOARD MEMBER REQUESTS TO TELECONFERENCE FOR “JUST CAUSE” OR “EMERGENCY,” AS SET FORTH ON THIS AGENDA BELOW

No discussion.

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, Callan LLC, stated Artisan Partners will review the international growth equity portfolio and Invesco will review the balanced-risk commodities portfolio.

2. Artisan Partners – International Growth Equity – Sean Howley, Andrew Euretig

TIME CERTAIN: 9:05 a.m.

Andrew Euretig, Managing Director and Portfolio Manager with Artisan Partners, reported the international growth equity strategy focuses on investing in enduring, sustainable growth opportunities. Preferred companies have reasonable valuations and managers with exceptional attributes who are able to capture the opportunities. The team looks for differentiated businesses with unique assets and tail winds of long-term secular growth. Mr. Euretig reported in 2022 the fund underperformed the benchmark. He is seeing strength in the fourth quarter of 2022 and in the first quarter of 2023.

Mr. Euretig discussed investment themes that are expected to play out over 3, 5 and 10 years. These include technologies that are changing the world, affecting people's lives, and delivering better societies. Demographics will drive demand for health care, and people are demanding more stringent environmental standards.

Mr. Euretig said the disruption of the financial system over the past few weeks is expected to impede the development of startup disruptors and entrench mature technology firms. As a result, the team is rotating the portfolio from financials into technology companies benefiting from long-term trends of artificial intelligence, data centers and machine learning. Another trend Mr. Euretig discussed is the expectation for regional banks to be disadvantaged and money center banks to be favored given either the higher cost of capital or increased regulations.

Chair Klein asked if Credit Suisse was a holding in the portfolio and to what extent the strategy relies on a low interest rate environment. Mr. Euretig replied Credit Suisse was not in the portfolio. He said high multiples of price relative to earnings are a function of low interest rates, and the ability of technology companies to outperform has been a tailwind for the strategy. Growth businesses will outperform over time, but tend to underperform in a high interest rate environment and during strong rotations into value. Mr. Euretig noted hyper-scale technology companies are still delivering 20% earnings growth at more reasonable valuations.

3. Invesco – Balanced-Risk Commodities – Dave Gluch, Delia Roges

TIME CERTAIN: 9:35 a.m.

Delia Roges, Managing Director for Invesco, said the balanced-risk commodities portfolio is model and rules based. Ms. Roges reported that the Invesco President and CEO Marty Flanagan will retire in June 2023 and will be succeeded by Andrew Schlossberg, Head of Americas. Ms. Roges introduced Dave Gluch, Client Portfolio Manager for the Global Asset Allocation team. Mr. Gluch reported commodities have improved since the multi-

year bear market ended in May of 2020. He noted the portfolio's relative performance to the benchmark over the past three years has been unusually variable.

Mr. Gluch addressed supply catalysts supporting a potential super cycle in commodities. He noted that producers under-invest in bear markets, and new supply takes a long time to get out of the ground. On the demand side, a major catalyst for commodity prices is green energy, which is global in nature and will take considerable metals and raw materials to implement.

Mr. Gluch discussed advantages of the balanced-risk commodities strategy over the Bloomberg Commodity Index (benchmark). He explained that the benchmark ignores long-term sources of return and allocates based on economic significance, measured through production weighting and trading liquidity. The benchmark is not measuring scarcity, he said, has a high weight for energy, and rebalances once per year. By contrast, Invesco considers four major sources of returns driving commodities. The first is a bias toward scarcity based on the shape of the futures curve. Second, the strategy considers the volatility and correlations of commodities. Commodities with less risk are given more weight to balance risk contribution, and the portfolio is rebalanced monthly. Mr. Gluch explained this process results in systematically selling high and buying low. Third, the strategy selects the contract that maximizes return and minimizes risk. Finally, the portfolio is rebalanced based on multi-factor, rules-based models to underweight commodities in bear markets and overweight commodities in bull markets. He also pointed out that when high-weighted commodities in the benchmark do well, the performance of the strategy lags the benchmark.

Mr. Gluch said the volatility, low correlation, and changes in leadership of commodity sectors over time support the strategy's rebalancing approach. Factors leading to moderating energy prices include the warm winter in Europe, China's COVID lockdown that suppressed demand, and central bank actions.

Trustee Vasquez asked about the source of underperformance in 2022. Mr. Gluch explained that tactical allocation, the rebalancing of strategic commodity weights, of natural gas resulted in half of the tactical loss due to extreme price volatility in the period prior to and during the Ukraine invasion. In response to Trustee Vasquez's inquiry, he discussed the relative volatility of commodities, noting natural gas is the most volatile. Chair Werby pointed out that over five years the portfolio has underperformed the benchmark. Mr. Gluch attributed this to the past two years when energy performed well.

C. NEW BUSINESS

1. Silicon Valley Bank Update – Jim Callahan, Callan LLC

Mr. Callahan discussed the series of events leading to the failure of Silicon Valley Bank (SVB) and Signature Bank. He noted the Federal Government stepping in to ensure the deposits in these banks was an important development. MCERA's direct security exposures to SVB and Signature Bank were small equity positions in the Russell 1000 Index. Mr. Callahan also discussed the recent issues with Credit Suisse, noting that Wellington held Credit Suisse senior debt which was not impaired. Junior Credit Suisse

bonds in the Western Asset core fixed income portfolio were written down to zero that had been valued at 2 basis points of its portfolio. Private debt manager CarVal also had exposure to these junior bonds. In aggregate, exposures to direct securities was relatively small when compared to the total portfolio.

Other exposures to SVB are within the private equity program that are invested in a series of fund vehicles. Both Abbott and Pathway held deposits at SVB across multiple funds of over \$20 million. Both Abbott and Pathway have since identified alternative sources to diversify their deposits. Mr. Callahan said another exposure is subscription lines of credit that help private equity managers with capital calls and distributions and to mitigate the J curve. Now, the managers will need to seek alternative sources for these lines of credit. The implication is the cost of capital will be higher and will ultimately affect returns. The other implication was the lending by SVB to venture companies which is now gone. Mr. Callahan concluded there is a void that needs to be filled, with the expectation that private capital will step into venture capital lending.

Trustee Werby noted the FDIC identified the problem at SVB and asked if bank personnel were unwilling or unable to act. Mr. Callahan explained Silicon Valley Bank had a unique business model concentrated on technology and venture capital. What happened is lending did not keep pace with increased deposits and deposits were invested in long duration bonds. In 2022 when rates went up, these bond prices went down. When depositors began to take money out, the bank was forced to liquidate securities. As the bank was not required to mark these assets to market, there was a big disparity in value. Chair Klein said her understanding is regulators told the bank to correct issues, but the bank never acted on its recommendations.

Trustee Silberstein noted there may be smaller banks with falling market values in MCERA's Fund whose total value may be significant. Mr. Callahan said there is a risk of contagion but it is hard to know to what degree that may happen. Chair Klein asked if Abbott or Pathway had staff monitoring the balance sheets of financial institutions and why they missed the imbalance. Mr. Callahan said the managers do have that function as part of their due diligence. He indicated the banks were surprised because the Fed aggressively raised interest rates over a short period of time. Chair Klein noted that Silicon Valley Bank had released a 10-K annual report at the end of February 2023 that showed the bank was undercapitalized. She said other venture capitalists noticed this, which led to large withdrawal requests from the bank in one day. She pointed out that Abbott and Pathway are supposed to be financially sophisticated gate keepers, terming the situation a major operational risk. Chair Klein said this could have been a catastrophe had the FDIC not stepped in. Mr. Callahan said the managers would have to be asked why they did not act sooner, adding they should have paid attention to the concentration of their exposure to Silicon Valley Bank.

2. Abbott Capital Management ACE VI Fund Extension (ACTION)

Consider, discuss and take possible action regarding Abbott Capital Management request for extension of ACE VI Fund

Mr. Wickman said MCERA's private equity program began in 2008 with \$100 million commitments each to managers Abbott Capital Management and Pathway Capital Management. Abbott's limited partnership agreement defined Abbott's ACE VI fund as a 12-year fund with three one-year extensions, all of which were executed. At the September 2022 Investment Committee meeting Abbott was asked about the fund's planned closing date of March 31, 2023. Subsequently, on March 8, 2023 MCERA received a letter from Abbott requesting that ACE VI limited partners consent to a two-year extension in order to have an orderly winddown.

The Administrator recommended that the Committee discuss this matter. Mr. Callahan explained that the terms of the extension are for a simple majority of limited partners to vote to consent to the extension. Trustee Silberstein recommended not agreeing to the proposed ACE VI fund extension and looking for a reduced fee. Mr. Callahan noted he had requested reconsideration of the fee on behalf of MCERA and received no indication the fee would be lowered.

Trustee Werby asked what was really going on. In response Mr. Callahan explained that the timing of MCERA's initial investment in 2008 coincided with the Great Financial Crisis. As a result, capital was called over a much longer period of time than was originally expected. He stated the other part is that Abbott found pricing was deeply discounted in the secondary market in the past year and felt that extending the time frame for the liquidation of ACE VI would improve pricing.

Trustee Vasquez asked what we know about the remaining portfolio companies and how to avoid this conversation once the extension time is up. Mr. Callahan pointed out that MCERA has received back \$154 million from its \$100 million investment in ACE VI and the remaining Net Asset Value is about \$42 million. Mr. Callahan said the good returns indicate it is possible either Abbott or the general partners could have sold the remaining assets sooner. The status of remaining companies is best provided by Abbott, he said. Mr. Callahan noted the private equity program has been the best performing asset class over its life, and Abbott and Pathway have been good partners.

Trustee Murphy asked if more extensions are likely, and Mr. Callahan replied there tend to be more extensions with private equity than you would like to see. Trustee Werby noted the fee is based on the remaining value, which may be changing. Mr. Callahan noted the valuations are being revised down on a quarterly basis. Trustee Gladstern asked if the private equity managers should have been at this meeting. Mr. Wickman replied the managers were not invited but staff had conducted extensive research on this issue. He stated Abbott has been very responsive to questions that MCERA has communicated to them regarding the extension. He stated that it has also been made clear to Abbott that the potential for an extension should have been discussed during the September 2022 Investment Committee meeting when the Committee Chair asked about the closing of the fund.

Chair Klein highlighted risks both private equity managers failed to mitigate or act upon: the failure to recognize that the decline in valuations that started in the fall of 2022 were not temporary; a lack of understanding of the impact of higher interest rates on long duration asset valuations; basing performance metrics on September 2022 valuations and continuing to relay those valuations as a basis for MCERA's decisions. Chair Klein indicated these communications on valuations do not reflect reality when we know that valuations are being reduced in some cases by 30%. Abbott is unable to articulate where the higher valuation will come from in the future, she said. Another risk she cited was a failure to properly diversify investments, noting 50% of the ACE VI remaining value is in venture capital growth equity. Finally, the Chair said there was operational risk in the failure to perform proper due diligence on SVB, thus exposing clients to credit risk. She opined that it appears the manager prioritized access to cheap debt to fund capital calls and increase returns over managing the risks of banking with a non-systemically important bank.

It was M/S Silberstein/Vasquez not to consent to the Abbott ACE VI fund extension and to direct the Administrator to write to the manager to explain the reasons for the vote. Trustee Gullett voted for the Third Member. The motion was approved by a vote of 8-1 as follows:

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

3. UBS Trumbull Property Fund (TPF) Extended Fee Program (ACTION)

Consider, discuss and take possible action regarding extension of UBS TPF fee program

Anne Heaphy, Senior Vice President with Callan, reported UBS is offering to extend the Loyalty Incentive Program for the Trumbull Property Fund that expires at the end of 2023. Ms. Heaphy noted there is some confidence the current team can turn performance around. As of December 2022, MCERA's fee savings through the program have been about \$200,000 per year.

It was M/S Silberstein/Cooper to extend the UBS Trumbull Property Fund Loyalty Incentive Program of 25% for another four years as of January 1, 2024. Trustee Gullett voted for the Third Member. The motion was approved by a vote of 9-0 as follows:

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

4. Investment Manager Personnel Update – TimesSquare Capital Management

Ms. Heaphy reported that International Small Cap Fund manager TimeSquare has parted ways with research analyst Robert Purcell. While a replacement is being sought, Magnus Larssen, co-Portfolio Manager, is covering the position. Callan does not believe any action is warranted at this time and will continue to monitor the situation.

Chair Klein recessed Open Session for a break at 10:51a.m., reconvening at 11:08 a.m.

5. Capital Market Assumptions (ACTION) – Jim Callahan, Jay Kloepper, Callan LLC

Discuss and review capital market assumptions and consider possible changes to current asset allocation

Mr. Callahan presented Callan's 10-year forward looking capital market expectations for asset class returns and risks. He pointed out that a lot has changed in the past year, leading to the biggest year-over-year change in the assumptions and expectations for the portfolio going forward. Mr. Callahan introduced Jay Kloepper, Executive Vice President and Director of Capital Markets Research.

Mr. Kloepper reported in 2022 the invasion of Ukraine by Russia led to inflation taking off and losses in fixed income and equity markets. Interest rates rose from a range of zero to 0.25% to a range of 4.25% to 4.50% by the end of the year. He said this is a compelling change in interest rates which matters a lot to the future and had a huge impact on the equity market. The volatility in the equity markets was not abnormal, he said, but the decline in the fixed income market due to the higher interest rates was unprecedented.

Discussing current market conditions, Mr. Kloepper said the market is fully pricing in a recession, as signaled by the inverted yield curve. Other recession signals he cited include initial unemployment claims creeping up, the weakening Purchasing Managers Index (PMI), weakening exports, and a lower Producer Price Index (PPI) as commodity and energy prices moderate.

Mr. Kloepper explained that in developing capital market assumptions Callan looks at long-term averages with judgment and is conservative with year-to-year changes. He said the expectation is for bonds to have a more normal yield and for equity values to be at a long-term average, rather than overvalued.

Callan's long-term capital market assumptions for 2023 through 2022 include:

- Inflation: 2.50%, increased by 25 basis points.
- Core Fixed Income core: 4.25% yield, increased from 1.75%.
- U.S. Equity: 7.35%, increased by 75 basis points.
- Global ex-US Equity: 7.45%
- Private Equity: 8.50%, increased by 50 basis points.

- Real Assets: 6.20%
- Private Credit: 7.00%, increased due to higher cash returns.

Trustee Werby was excused from the meeting at 11:19 a.m.

Mr. Kloepper discussed expected returns for alternative asset mixes constrained to 15% real assets. The projected return is 7.2% for Mix 3 which is similar to MCERA's current asset allocations. He indicated the Committee could consider de-risking the Fund since the current assumed rate of return of 6.75% is below the new projected return.

The trustees discussed their preferences for changes in the asset allocation of the Fund. Trustee Silberstein, noting MCERA is a long term investor and can withstand volatility, proposed reducing fixed income from 23% of the Fund to 18 or 19% of the Fund due to its lower expected return. Chair Klein proposed settling on Mix 2 that increases fixed income a little, decreases international equity a little, and reduces the current overall standard deviation.

Trustee Vasquez suggested building asset classes with negative correlations. Mr. Kloepper explained that negatively correlated assets are hard to find. He stated the best diversifier to equities is fixed income, and real assets are meant to be a diversifier. Mr. Callahan added the other asset class with a low correlation to equities would be hedge fund strategies. Trustee Vasquez also suggested increasing the allocation to international equities and cash until things get clearer. Mr. Callahan noted cash in the Fund is securitized by the futures overlay program, which has been incredibly additive to performance. He added that cash is a major drag on return expectations, noting that the benefit of the long-term time horizon is not having to be too tactical. He suggested increasing fixed income as a conservative approach.

Trustee Cooper was excused from the meeting at 12:29 p.m.

In conclusion, Mr. Callahan said a lot has changed year over year and it is prudent to reconsider the risk posture of the Fund. He said the current return assumption is reasonable. Trustee Silberstein said this topic should be considered at a future meeting.

6. Future Meetings

No discussion.

D. INVESTMENT CONSULTANT QUARTERLY REPORT

1. Summary Report as of December 31, 2022

Ms. Heaphy reported in the fourth quarter of 2022 the fixed income portfolio was adjusted to transfer assets out of the Colchester global bond portfolio and into the Wellington and Western asset portfolios. In addition, the Western Asset portfolio strategy was changed from intermediate credit to core plus. Ms. Heaphy reported as of December 31, 2022 the Total Plan value is over \$2.9 billion and Fund performance rebounded with a 5.27% return net of fees in the 4th quarter. Over the long term returns are generally in the top quartile of the peer group. Fund returns are relatively flat on a net basis for the fiscal year

beginning July 1, 2022. For the calendar year domestic equity portfolio held up well, international equities lagged the target return, and fixed income returns were negative.

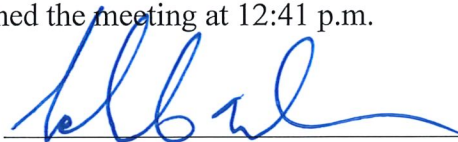
a. Flash Performance Update as of February 28, 2023

Through February 28, 2023 fiscal year to date initial returns show generally equity managers are doing well and fixed income returns are slightly negative. In the public real assets portfolio, Invesco commodities and KBI global resources rebounded. Mr. Callahan noted the expectation is for write-downs in private equity and real estate valuations going forward.

There being no further business, Chair Klein adjourned the meeting at 12:41 p.m.



Sara Klein
Investment Committee Chair



Attest:
Jeff Wickman, Retirement Administrator