

MINUTES

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

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

March 20, 2024 – 9:00 a.m.

This meeting was held at the address listed above and, absent technological disruption, was accessible via videoconference and conducted in accordance with Government Code section 54953 and 54954.2.

CALL TO ORDER

Chair Klein called the meeting to order at 9:02 a.m.

ROLL CALL

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

ABSENT: Werby, Martinovich

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

No Board members requested to teleconference.

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, said TimesSquare will give an update on the active international small cap equity portfolio.

2. TimesSquare – International Small Cap Fund – Magnus Larsson, Jeff Braemer TIME CERTAIN: 9:05 a.m.

Jeff Braemer, Head of Client Services with TimesSquare, introduced Magnus Larsson, Portfolio Manager for the International Small Cap Fund. Mr. Larsson said the investment strategy is to focus on well-managed companies with a distinct competitive advantage. The investment team looks for high operating margins and high returns, following up with fundamental analysis to gain an understanding of where the numbers come from. The analysis incorporates financial modeling, valuation, and trends. Mr. Larsson stated over time portfolio holdings have higher return on equity than in those in the MSCI EAFE Small Cap Index.

Mr. Larsson said since coming out of Covid the international small cap equity market overlooked company fundamentals. The result has been that performance has not lived up to expectations. The investment team makes sure to maintain the investment discipline in the belief that the investment strategy works over time. Trustee Vasquez asked why performance has improved and what the outlook is going forward. Mr. Larsson explained company fundamentals had been set aside but the market environment has stabilized and he is expecting consistent earnings growth over time for the portfolio.

Trustee Silberstein said he learned at a conference that Japanese companies are not managed to benefit shareholders and do not manage cash well. Mr. Larsson replied over the last decade Japanese companies have not managed cash with shareholders in mind. He indicated there is an important change happening after the stock exchanges required companies trading at less than book value to reallocate cash to shareholders. As a result, in 2023 there was high demand for companies to return cash. This money is now being invested in entrepreneurial companies which is expected to create a multi-year opportunity.

Trustee Silberstein noted in the 10 largest holdings some companies increased in value 30% in two months and asked if they would continue to rise in price. In response, Mr. Larsson said two companies have increased earnings above expectations and the valuation remains attractive. Mr. Larsson said by watching fundamentals these companies may be sold based on valuation. He noted one investment is not allowed to become over 5% of the portfolio value.

Trustee Poole asked about investing in emerging markets in Africa. Mr. Larsson replied most African markets are frontier markets that are too far out on the risk curve for this portfolio. He said Africa has the potential to become a good opportunity in the future. Chair Klein asked about the Bank of Japan's interest rate policy. Mr. Larsson noted there

is evidence of inflation in Japan so he is not surprised by the interest rate increase and is expecting more rate hikes in the future.

C. NEW BUSINESS

1. Capital Market Assumptions (ACTION) – Jim Callahan, Jay Kloepfer, Callan LLC
Discuss and review capital market assumptions and consider possible changes to current asset allocation

Jim Callahan introduced the capital market assumptions presentation. Callan revises its 10-year projections every year. He encouraged considering what the drivers are in the current environment and whether there are any changes to the portfolio needed as a result. For example, given the rise in interest rates Callan has increased bond return projections again this year. He indicated derisking the Fund by increasing the fixed income allocation should be considered.

Jay Kloepfer, Executive Vice President at Callan, stated Callan's capital market assumptions projected over the next ten years are very important. The assumptions are conservative and biased to long-term averages in the belief markets return to rational levels. The projection process uses advanced models for bonds and equities and considers the path for interest rates and inflation to help make sense of market conditions.

Capital market assumptions for broad MCERA asset classes projected for 10 years are: broad U.S. equity 7.65%, global ex-U.S. equity 7.65%, U.S. fixed income 5.25%, private equity 8.75%, and real assets 6.60%. The inflation assumption is 2.5%. Mr. Kloepfer pointed out that the fixed income projected return is up from 4.25% a year ago.

Mr. Kloepfer said current market conditions differ from expectations for an economic slowdown. The U.S. economy has been growing, the job market is strong, and beginning in May of 2023 wages had a positive real return. Callan believes the Federal Reserve (Fed) will no longer raise interest rates but will keep higher interest rates for longer. In the capital markets equities have recovered from the 2022 downturn, the fixed income market has not recovered as much, and there are challenges in real estate. Equities have performed well over the last 10 years, and looking forward Callan has strong expectations for fixed income returns. Mr. Kloepfer pointed out that with rising interest rates over the last few years stocks and bonds have become more correlated.

Mr. Kloepfer indicated housing, services, and food and beverage prices are factors in inflation. Through December 2023 inflation gradually declined, and the bond model breakeven rate shows inflation to be above 2% and below 2.5%. Mr. Kloepfer expects short-duration interest rates to come down and is projecting a normal yield curve over time, rather than inverted.

For MCERA's current asset allocation the expected compounded return over 10 years is 7.6%. Mr. Kloepfer presented 5 asset mixes and expected returns using a U.S. fixed income allocation ranging from 32% to 20%. The data includes ranges of projected rates of return and probabilities for achieving the current assumed rate of return of 6.75%.

Trustee Silberstein suggested eliminating the commodities allocation from the real asset allocation since the expected return is among lowest of all asset classes with high volatility. Trustee Gladstern supported his view. Mr. Callahan replied the correlation with other assets is low, which is a diversification benefit, but it would be reasonable to consider replacing commodities in the real asset allocation. Chair Klein agreed with Callan's recommendation to reduce the equity allocation and increase the fixed income allocation in order to reduce volatility and risk in the portfolio. She expressed a preference for moving MCERA's portfolio from the current Mix 4 into Mix 2, but would be willing to consider Mix 3 as well. She noted that based on Callan's modeling, the future expected returns from Mix 2 and Mix 3 were virtually the same as MCERA's current Mix 4 but resulted in a dramatic reduction in standard deviation. Given the sharp rise in interest rates and the maturity of MCERA's Plan, Chair Klein felt it was prudent to reduce risk.

Trustee Silberstein stated he is in favor of Mix 5 which would reduce the fixed income allocation, noting bonds are very correlated with equities and have a lower expected return than equities. Chair Klein noted fixed income yields are significantly higher than a few years ago. Trustee Vasquez asked where along the yield curve the Fund is most exposed. In response Mr. Callahan said MCERA's fixed income managers have active core plus strategies and invest along the entire yield curve. The result of that exposure is a duration that is close to the Bloomberg Aggregate Index. Trustee Gladstern expressed a preference to stay with Mix 4 allocations, and Trustees Cooper and Murphy supported her view. Chair Klein asked if any Committee members wished to make a motion. Hearing none she moved to the next agenda item.

2. Fixed Income Allocation (ACTION)

Review, discuss and take possible action on fixed income allocation

See discussion above.

3. Investment Manager Updates

a. Dimensional Fund Advisors Co-CIO Announcement

Anne Heaphy, Senior Vice President at Callan, reported that Dimensional Fund Advisors announced the promotion of Savina Rizova, Global Head of Research, to Co-Chief Investment Officer (CIO) with Gerard O'Reilly. She said it is normal policy for this firm to have a Co-CIO policy which is good succession planning.

b. UBS Trumbull Property Fund Updates

Throughout 2023 UBS engaged in a strategic capital initiative process for the Trumbull Property Fund in order to address the redemption queue that is currently 60% of the Net Asset Value of the fund. After discussions with potential bidders no agreement has been reached. UBS will continue to consider offers but is proceeding as usual with the Fund. MCERA is using the loyalty program's 25% discount for a 4-year commitment which has transitioned to a 25% reduction in perpetuity. In addition, UBS removed the clawback of redemption fees.

c. AEW Core Property Trust Updates

The two senior portfolio managers leading the AEW Core Property Trust, Lily Kao and Sara Cassidy, have been promoted and assigned additional responsibilities. As a result, they will spend 75% of their time on the Core Property Trust. Callan believes Kao and Cassidy are well equipped to continue leading the fund and will monitor this situation.

4. Investment Policy Statement Update (ACTION)

Consider and take possible action on recommended amendment to the Investment Policy Statement

a. Appendix B-3, State Street Global Advisors MSCI World ex-US Index Fund, Statement of Objectives, Guidelines & Procedures: Update Performance Objectives

Mr. Wickman presented updated performance objectives for the State Street Global Advisors MSCI World ex-US Index Fund Statement of Objectives, Guidelines & Procedures that were recently adopted by the Investment Committee.

It was M/S Cooper/Vasquez to approve the amendment to the Investment Policy Statement, Appendix B-3, State Street Global Advisors MSCI World ex-US Index Fund as presented. The motion passed by a vote of 8-0 as follows:

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

5. Future Meetings

Trustee Gladstern suggested having a discussion about commodities in the real assets sleeve and education on alternative investments such as infrastructure.

D. INVESTMENT CONSULTANT QUARTERLY REPORT

1. Summary Report as of December 31, 2023

Mr. Callahan presented Callan's Summary Report for the quarter ending December 31, 2023. He pointed out the one-year -12.7% trailing return for the U.S. private real estate benchmark NCREIF ODCE with a modest 2.8% income return. In addition, global private equity through September 2023 returned 4.2% over 12 months, trailing the public market Russell 3000 PME benchmark return of 21.5%. Mr. Callahan said Venture suffered the most and Buyouts performed better in the period. There was a slowdown in private equity in 2023 as it absorbed the sharp rise in interest rates in 2022. Over the long term private equity is expected to have a premium over public equity returns.

Trustee Vasquez inquired about leverage in the private equity funds. Mr. Callahan replied the private equity general managers do not add leverage to the underlying funds. He said leverage would be used more for Buyouts, noting the increased cost of capital puts pressure on fund returns.

As of December 31, 2023 the Fund's asset allocations were within target ranges. The Fund is overweight to private equity but within the policy range. The report presents Fund returns as compared with its peer group over different time frames as of December 31, 2023. For one year the Fund returned 11.01% net of fees, slightly below the peer group. Long-term returns on a net basis outperformed MCERA's target and performance is in the top quartile of peers. Mr. Callahan reported the Fund's fiscal year-to-date return is 4.10% and equity markets continue to perform well in March 2024.

Mr. Callahan reviewed the Fund's asset classes, explaining that the State Street Global Advisors Russell 1000 Index fund is 75% of domestic equity assets. Small cap core equities managed by Dimensional Fund Advisors (DFA) represent the remaining portion of domestic equities. The Fund's significant small cap tilt to the Russell 3000 benchmark was a headwind for the calendar year.

In the international equity portfolio active managers Morgan Stanley and Artisan were replaced by the MSCI World ex-US Index, with new allocations added to the Fidelity emerging markets equity and TimesSquare International Small Cap portfolios. International portfolios returned 14.4%, with Morgan Stanley and Artisan underperforming benchmarks and Fidelity outperforming its index.

The fixed income portfolio is managed by Wellington Management Company and Western Asset Management Company which employ active core plus strategies. Fixed income is overweight to corporate bonds and asset-backed securities and underweight to U.S. Treasury's. Both managers outperformed respective indices over one year.

The core real estate portfolio managed by AEW and UBS had a negative 12% return for calendar year 2023. AEW outperformed the benchmark, and write-downs continue in the Office sector. Chair Klein asked if given lower valuations investors might consider adding to real estate allocations rather than redeeming funds. In response, Mr. Callahan indicated those in redemption queues prefer a wait-and-see mode regarding how real estate managers will handle distressed assets and impending debt coming due in 2024 and 2025.

MCERA's public real asset portfolio returned 5.7% for 2023, outperforming the target return. Diversification helped due to the weakness in real estate. Notably, Invesco commodities and KBI natural resources had good relative performance in weak environments.

In the private equity portfolio 84% of MCERA's \$500 million commitment is paid in. Since inception MCERA has received \$489 million in distributions. The Total Value to Paid In (TVPI) is 1.98 and the net Internal Rate of Return (IRR) is just under 15% over the history of the program.

MCERA has committed \$100 million to the Opportunistic portfolio of which over 70% is paid in. This private debt portfolio is still in investment mode. Since inception the net IRR is 7.7%, with further upside expected by the three managers.

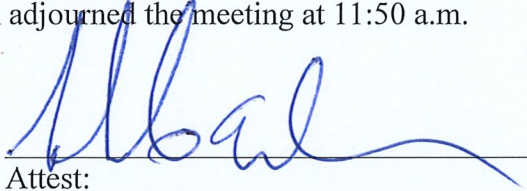
a. Flash Performance Update as of February 29, 2024

Mr. Callahan reported on the Flash Performance update as of February 29, 2024. Total Fund assets are \$3.3 billion and the fiscal year-to-date return is 6.4%. In that period domestic equities were up 14.7% and the international equity portfolio returned 8.0%. TimesSquare international small cap equities and Fidelity Institutional Asset Management emerging markets portfolios look good on both a fiscal year and calendar year basis, he said. In conclusion, Mr. Callahan said economic growth is still strong and the Fed is expected to cut interest rates this year.

There being no further business, Chair Klein adjourned the meeting at 11:50 a.m.



Sara Klein
Investment Committee Chair



Attest:
Jeff Wickman, Retirement Administrator