MINUTES

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

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

March 21, 2018 – 9:00 a.m.

The Board of Retirement for the Marin County Employees' Retirement Association encourages a respectful presentation of public views to the Board. The Board, staff and public are expected to be polite and courteous, and refrain from questioning the character or motives of others. Please help create an atmosphere of respect during Board and Committee meetings. If members of the public wish to speak on any agendized items, please alert the Retirement Administrator to that request prior to the matter being called.

CALL TO ORDER

Chair Given called the meeting to order at 9:01 a.m.

ROLL CALL

PRESENT: Block, Given, Gladstern, Jones (alternate retired), Klein, Murphy, Shaw (ex officio alternate), Silberstein, Thomas, Werby

ABSENT: Cooper, Piombo (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 public comment.

B. MANAGER ANNUAL REPORTS

1. Manager Overview – *Jim Callahan, Callan Associates*

   Jim Callahan, Executive Vice President with Callan Associates, opened the discussion by introducing MCERA's three international equity managers. Morgan Stanley and Artisan invest in primarily large caps in developed markets, and Fidelity Institutional Asset Management is a small cap manager. The international equity portfolio has done well over time and 2017 was a good year, with international markets outperforming domestic as the U.S. dollar weakened against foreign currencies.

2. Morgan Stanley, International Equity – *Jill Ytuarte, Bruno Paulsen – 9:05 a.m.*

   Bruno Paulsen, Managing Director and Portfolio Manager with Morgan Stanley, stated the basic philosophy for the international equity strategy is to hold a mix of very high-quality companies that compound earnings steadily over time. In addition, the investment team exploits value opportunities when normal companies are expected to get better. Mr. Paulsen said the firm aligns interest with clients by owning companies in the portfolio. The investment decisions are made as a collective of specialists who have considerable overlap in sector experience. The Morgan Stanley international equity portfolio returned 25.42% net of fees for the year ending December 31, 2017 (versus 25.03% for the MSCI EAFE Index).

   Currently, the portfolio is weighted toward market compounders since there is not enough margin of safety on lower-quality companies. Mr. Paulsen stated as long-term investors the team believes that environmental, social and governance matters are important because they can affect profitability over time. For example, the team engages managers regularly on governance matters such as executive pay. Due to concern for the environment and potential trapped assets, the portfolio is underweight energy and holds positive alternatives such as biodiesel. Trustee Silberstein asked about the status of British American Tobacco (BAT), noting its stock price recently declined due to the threat of more regulation. In response, Mr. Paulsen explained that BAT remains in the portfolio because of its pricing power and its strong position as one of two companies in the world positioned for the next generation of products with its acquisition of Reynolds.

   Currently, the portfolio is defensively positioned and holdings have high return on capital as compared to the MSCI EAFE index and significantly less debt. The portfolio is overweight to the consumer staples and health care sectors. Within consumer staples, the portfolio is weighted to personal products in brands that are penetrating the market. Exposure to growing populations in emerging markets is an important factor. There is a significant underweight in the consumer discretionary and financial sectors; recently, more investments have been made in European banks. The industrial sector is slightly underweight; within that quality mix, there are no transportation companies because they are highly capital intensive and cyclical. The portfolio is significantly underweight in the capital goods sector; the largest holding is a company building engines for narrow body jets. The portfolio has significant overweights to commercial and professional services with high return on capital.

Trustee Silberstein asked if passive investing is causing pressure to lower fees. Mr. Paulsen replied there is pressure to prove value as an active manager. The point of active investing, he said, is to deliver something different from an index. Portfolio holdings have better return on capital, higher gross margins, a higher price/earnings multiple, and lower net debt as compared with the benchmark. Ms. Ytuarte pointed out that fees were reduced in 2017 for the vehicle MCERA is invested in.

Trustee Block asked what percentage of revenue is from the United States (U.S.), and how U.S. trade policy would affect the portfolio. In response, Mr. Paulsen estimated U.S.-based revenue to be 22% and said this portfolio would be slightly less affected by trade policy. A significant trade war would affect valuations across the board and would slow the world economy, he added. In response to Trustee Gladstern's inquiry on whether the firm is preparing for Brexit, Mr. Paulsen indicated the United Kingdom (U.K.) represents a relatively small percentage of the portfolio, and there are no U.K. banks in the portfolio.

3. Fidelity Institutional Asset Management, International Small Cap Equity – *Nick Horn, Melissa Boissy – 9:30 a.m.*

   Nick Horn, Institutional Portfolio Manager with Fidelity Institutional Asset Management, (FIAM) reported that Rob Feldman, the Portfolio Manager of the international small cap equity strategy, will be decreasing his role with the strategy and eventually going on medical leave. The plan is for the Associate Portfolio Manager Shah Badkoubei to transition into the Portfolio Manager position. Chair Given asked that the investment consultant comment, and Mr. Callahan stated he was just notified about Mr. Feldman's status on Monday when he discussed it with Mr. Wickman. Mr. Callahan said he believes this is a significant change. As a result, Chair Given requested that an item be added to today's agenda to consider the status of the international small cap allocation.

It was M/S Gladstern/Murphy to add *Item C.1, Consider and take possible action regarding MCERA's international small cap equity allocation with Fidelity Institutional Asset Management*, to the agenda for this meeting because three is a need to consider action before the next Investment Committee meeting and the need for action came to the attention of MCERA after the Investment Committee agenda was posted. (Gov. Code sec. 54954.2(b)(2))

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

Mr. Horn stated the investment philosophy is that international small cap equities are an inefficient, under-covered asset class. As such, there are frequent opportunities to purchase securities that are undervalued. The investment team emphasizes fundamental, bottom-up, stock-specific research and meeting with company representatives to systematically capture value. The Fidelity Institutional Asset Management international small cap equity portfolio returned 31.98% net of fees for the year ending December 31, 2017 (versus 33.47% for the S&P EPAC Small Cap Index).

Mr. Horn presented metrics showing strong general market conditions during 2017 for international small cap equities. The strongest sector was information technology followed by health care. Regionally, Europe excluding the U.K. was the strongest region. Mr. Horn attributed slight underperformance to the benchmark during 2017 to cash drag in the pooled vehicle, sector selection, and stock selection. Highlighting top-performing stocks, Mr. Horn noted most were not in the best performing regions. Portfolio characteristics including regional, sector and country weights show the portfolio is relatively region and sector neutral.

Trustee Block asked what percentage of revenue in the portfolio would be attributable to the U.S. market, and Mr. Horn replied he will follow up with that information. Trustee Werby inquired about the footnote on page 19 regarding other fees and expenses and the meaning of fair value pricing. In response, Mr. Horn stated all fees are incorporated in the reported net performance values. Fair value pricing is a protection for pool participants from daily arbitrage in the fund.

Trustees Gladstern and Werby inquired about the timing and nature of the transition in portfolio manager position. In response, Mr. Horn indicated he expected Mr. Feldman to participate in the transition and take a leave of absence in 18 months. Mr. Horn said Mr. Feldman is currently fully engaged and having daily meetings; the Fidelity research platform is dong the heavy lifting, Mr. Horn said, and the investment team is fully integrated so he does not expect there to be an issue.

4. Artisan Partners, International Growth Equity – *Sean Howley, Andrew Euretig – 9:55 a.m.*

Andrew Euretig, Managing Director and Associate Portfolio Manager for the Artisan Partners international growth strategy, discussed macroeconomic conditions affecting portfolio positioning. Mr. Euretig said over the past decade markets have been in post-financial crisis conditions of global quantitative easing and a declining interest rate environment. Events such as the August debt scare in China and subsequent turnaround, and Brexit, affected performance. Since 2016, the investment team has made good progress in rectifying what was not working in the portfolio. The portfolio was modified to change some positions in the materials sector and add to technology and financial sectors, as the market environment became more stable and positive than the investment team had thought. As a result, these sectors contributed to outperformance to the benchmark during 2017. The Artisan Partners international growth equity portfolio returned 31.24% net of fees for the year ending December 31, 2017 (versus 25.03% for the MSCI EAFE Index).

In implementing the investment strategy, the team invests in growth companies with big ideas that innovate. Over time, bottom-up stock picking and sector allocation has contributed to outperformance of the portfolio. Mr. Euretig stated the portfolio is performing well so far in 2018, and the top ten positions represent 30 to 40% of the portfolio. The investment team is comfortable with allocations that are positioned for the tectonic shift of a rising interest rate environment.

Trustee Silberstein inquired about one of the top ten holdings, Nestle. In response, Mr. Euretig said Nestle has been in the portfolio for 15 years; the team is strong on consumer

staple firms with familiar products and good innovation that generate dividends. Mr. Euretig acknowledged changing trends in consumer choice related to organic foods and Amazon's purchase of Whole Foods. Trustee Block asked about the relative amount of U.S. revenue for holdings in the portfolio, and Mr. Euretig offered to follow up with that information.

Chair Given recessed the meeting for a break at 10:14 a.m., reconvening at 10:28 a.m.

C. NEW BUSINESS

1. Consider and take possible action regarding MCERA's international small cap equity allocation with Fidelity Institutional Asset Management.

   Mr. Wickman stated that Fidelity Institutional Asset Management contacted him Monday to discuss the status of Portfolio Manager Rob Feldman. On Tuesday, Mr. Wickman received written notification which was then discussed with Jim Callahan and Anne Heaphy at Callan Associates. The general agreement was that the matter should not sit for 60 days until the next Investment Committee meeting before being discussed with the Committee. Mr. Callahan stated Callan Associates is not comfortable with the change in portfolio management because Rob Feldman is key to the strategy and Callan's understanding is that he was relinquishing his portfolio manager duties effective immediately. Mr. Callahan said the impact was serious enough that MCERA should strongly consider what the strategy should be for the long term; in the short term, the situation is not critical. In response to Trustee Block's inquiry, Mr. Callahan explained the role of the FIAM international small cap portfolio in the Fund and noted that revenue sources can fluctuate among managers.

   Chair Given requested Mr. Callahan's recommendation and he stated that Callan Associates recommends hiring a replacement manager for the international small cap allocation. In response to Trustee Thomas's inquiry, Mr. Callahan explained that Callan would be concerned about the lack of experience for the incoming manager who is replacing Mr. Feldman.

   Chair Given recommended that Callan Associates conduct a search for a replacement manager. In the meantime, Chair Given requested further discussion on international equity allocation options prior to making a decision. Mr. Wickman and Mr. Callahan agreed there could be further discussion during the Strategic Workshop and at the next Committee meeting in June, followed up by results of the manager search. Mr. Callahan stated he will come back with both active and passive alternatives as part of the manager search.

It was M/S Block/Gladstern to direct Callan Associates to conduct a search for vehicles for the international small cap equity allocation.

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

2. Dimensional Fund Advisors (DFA) Core Fund Transition (**Action**)
Consider, discuss and take possible action regarding DFA portfolio transition

Mr. Callahan stated that at its last meeting, the Investment Committee decided to terminate Columbus Circle as the small cap growth manager and move all small cap equity assets into the Dimensional Fund Advisors U.S. Small Cap Core strategy. The decision was to move into the commingled trust vehicle, recognizing the assets could be moved to a separate account in the future. The plan was to have further education on the benefits and considerations of separately managed accounts and commingled vehicles at the upcoming workshop. However, he indicated that the most efficient process would be to wait until the final decision was made on what vehicle would be chosen. In his memo on the matter, Mr. Callahan outlined the transition process depending on the account vehicles involved.

Trustee Silberstein indicated a preference to move the assets into a separately managed account now, and then go into the commingled trust if we want to. Mr. Callahan re-iterated that there were two transition activities that needed to take place: moving Columbus Circle and DFA Small Cap assets into the new DFA Core Fund. Moving either of these assets into the DFA Small Cap Core commingled fund requires the use of a transition manager. Trustee Werby asked about cost and in response, Mr. Callahan said that transition managers argue they can save money in the transition. Responding to Trustee Klein's inquiry on why a transition manager was needed, Mr. Callahan said there are multiple features of a transition manager; one is not to have so much cash exposure during the transition. Transitioning the Columbus Circle and DFA Value assets to DFA Small Cap Core separate account would not require a transition manager. However, because the Board had previously voted to use a commingled account for the DFA Small Cap Core fund, the Board would need to change that decision.

Mr. Wickman suggested the Committee wait to make a change to the prior decision until further discussion scheduled for the April Workshop on the domestic equity allocation.

It was M/S Silberstein/Gladstern to change the vehicle for the Dimensional Fund Advisors (DFA) small cap core strategy from the DFA U.S. Small Cap Trust to a DFA separate account.

Trustee Block expressed a preference for more discussion before making this decision. Mr. Callahan said that the more important decision is how to transition the assets most efficiently, because it is a different transition process. Trustee Murphy also prefers to wait until further discussion before moving the small cap assets. Other trustees noted their preference to move forward with the transition.

Trustees Silberstein and Gladstern amended their respective motion and second above to include transitioning both the Columbus Circle small cap growth and DFA small cap value portfolios to the DFA core small cap separate account.

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

Chair Given explained that he prefers having more discussion prior to making decisions.

D. INVESTMENT CONSULTANT QUARTERLY REPORT and PERFORMANCE UPDATE

As of December 31, 2017

Anne Heaphy reported that total Fund assets grew by $68 million to $2.46 billion during the quarter ending December 31, 2017. During the quarter the RREEF real estate portfolio was fully liquidated; the AEW value real estate portfolio is close to full liquidation. Ms. Heaphy presented asset allocations and reported all sectors are within target ranges. Peer group comparisons of Fund returns show MCERA slightly trailed the composite benchmark for the quarter; for remaining time frames, the Fund outperformed the benchmark on a gross of fees basis and ranked in the top quartile of the Callan Public Fund Sponsor – Large peer group. Historical fiscal year returns show the Fund has outperformed the composite benchmark since 2011 (gross of fees).

Ms. Heaphy discussed portfolio manager performance. In the domestic equity portfolio, the S&P 500 Index fund, representing large cap equities, returned 6.64% during the quarter and 20.6% for the calendar year. In domestic small cap equities, the Dimensional Fund Advisors small cap value portfolio outperformed the Russell 2000 Value Index during the quarter and slightly underperformed for the calendar year. The Columbus Circle small cap growth portfolio outperformed the Russell 2000 Growth Index for the quarter and for the calendar year. The reason domestic equities trailed the composite benchmark during the quarter is the overweight to small cap in the Fund.

The international equity managers had strong performance for the calendar year, returning 28.92% versus 27.81% for the International Benchmark. Ms. Heaphy pointed out that the Parametric emerging markets portfolio underperformed its benchmark due to its underweight to China, which has become nearly 30% of the emerging markets index. Callan Associates is having discussions with Parametric about the appropriate weight for China. Mr. Callahan indicated China may become 50% of the index with the gradual inclusion of China A shares, which forces everyone to think differently about the exposure to emerging markets.

The fixed income portfolio had a modest return for the quarter, slightly trailing the benchmark due in part to exposure to Mexico in the Colchester portfolio that was affected by trade policy. All three fixed income managers outperformed their benchmarks for 2017. The strongest performing sector was intermediate credit, which is Western Asset Management's mandate.

Real assets slightly underperformed the composite benchmark, returning 2.8% for the quarter and 7.2% for the year. The core real estate portfolio returned 1.9% for the quarter and 5.66% for the year. The UBS portfolio trailed the benchmark NFI-ODCE Equal Weight net index for the year due to having lower leverage than the benchmark. In the public real assets portfolio, returns outperformed the benchmark for the quarter and the calendar year. The real assets portfolio consists of equal weights to the BlackRock TIPS Index Fund, BlackRock REIT Index Fund, Invesco Commodity Fund, and KBI Global Resources Fund. The commodities portfolio benefited from energy, cotton and sugar allocations, and the global resources portfolio trailed for quarter but outperformed for the year due to no energy exposure.

In conclusion, Ms. Heaphy reported that for the quarter ending December 31, 2017, the total Fund was up 3.37% net of fees, versus 3.73% for the composite benchmark, and for the year the total Fund returned 16.27% net of fees, versus 16.02% for the composite benchmark.

Trustee Block requested historical performance ratios for the private equity fund vehicles. Mr. Callahan indicated that data can be provided; he added the ratios are the most important metric in the valuation of private equity. For example, Total Value to Paid-In Capital ratio for the overall private equity portfolio of 1.39 defines what the current value of the portfolio is relative to what MCERA has paid in. In early stages the value shows up in the net asset value, and then later through more distributions back to MCERA. The takeaway is that most of the value is still in the ground and still needs to be realized, Mr. Callahan said.

Trustee Gladstern asked about volatility in the equity markets. In response, Mr. Callahan said volatility has increased back to historic norms; during 2017, the VIX (CBOE Volatility Index) closed below half the normal level over 50 times. Mr. Callahan said the fundamental corporate story still looks favorable due to tax reform, repatriation of overseas capital, strong earnings and low unemployment. With stock valuations high, Mr. Callahan advised thinking long term and being disciplined about rebalancing as the prudent course in terms of managing risk. Trustee Klein said there may be times to consider derisking the portfolio. In response, Mr. Callahan said there are times not to chase returns and to know when the risk/reward tradeoffs are attractive, which they are not right now. Mr. Wickman referred to a risk mitigation strategy presented during the CalAPRS General Assembly. Mr. Wickman emphasized the key take away from the presentation was the ability of the governing body to maintain any risk mitigation strategy it implements over a long period of time. He offered to send the presentation to the full Committee.

Chair Given observed the passing of former trustee Allen Haim. Trustee Jones invited the trustees to memorial services and thanked Mr. Wickman for his tribute to Allen. Mr. Haim was credited by Trustee Gladstern for establishing fiduciary liability insurance for MCERA. Counsel Dunning said she appreciated Mr. Haim's contributions to the Board and counsel and that he will be missed. Mr. Wickman said Mr. Haim had a sharp mind and was always concerned about our members and beneficiaries.

There being no further business, Chair Given adjourned the meeting in memory of Allen Haim at 12:15 p.m.

Roy Given, Chair

Attest: Jeff Wickman
Retirement Administrator