ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM
BOARD OF RETIREMENT
2223 E. WELLINGTON AVENUE, SUITE 100
SANTA ANA, CALIFORNIA

INVESTMENT COMMITTEE MEETING
January 25, 2017

MINUTES

Attendance was as follows:

Present: Chris Prevatt, Chair; Wayne Lindholm, Vice Chair; Eric Gilbert; Charles Packard; Russell Baldwin; Thomas Flanigan; Roger Hilton; David Ball; Frank Eley; and Shari Freidenrich

Also Present: Steve Delaney, Chief Executive Officer; Brenda Shott, Assistant Chief Executive Officer, Internal Operations; Shanta Chary, Director of Investment Operations; David Beeson, Investment Officer; Adam Cheng, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Gina Ratto, Chief Legal Officer; Anthony Beltran, Visual Technician; and Julius Cuaresma, Recording Secretary

Meketa Investment Group: Stephen McCourt, CFA and Laura Wirick, CFA
Pension Consulting Alliance: Allan Emkin

The Chair called the meeting to order at 9:05 a.m. and led the Pledge of Allegiance.

CONSENT AGENDA

All matters on the Consent Agenda to be approved by one action unless a Committee Member or a member of the public requests separate action on a specific item.

Mr. Baldwin stated that due to his recent 2017 OCERS' Board of Retirement appointment, he will abstain from the Consent Agenda vote, which includes the approval of the December 2016 Investment Committee Meeting minutes.

A **motion** was made by Mr. Eley and **seconded** by Mr. Flanigan to approve the Consent Agenda. The **motion carried** with Mr. Baldwin abstaining.

C-1 COMMITTEE MEETING:

Approval of Meeting and Minutes
Investment Committee Meeting December 14, 2016

Recommendation: Authorize meeting and approve minutes.

C-2 QUIET PERIOD - INVESTMENT RELATED SEARCHES

Recommendation: Receive and file.

C-3 INVESTMENT MANAGER FEE STRUCTURE UPDATES

Recommendation: Receive and file.

C-4 ECONOMIC DASHBOARDS

Recommendation: Receive and file.

*** * * * * * * END OF CONSENT AGENDA * * * * * * ***

INDIVIDUAL ITEMS AGENDA

I-1 INDIVIDUAL ACTION ON ANY ITEM TRAILED FROM THE CONSENT AGENDA

I-2 CEO & STAFF COMMENTS
Presentation by Steve Delaney, CEO & Shanta Chary, DIO, OCERS

Mr. Delaney provided an update on his oversight of the Investment Department. He discussed his increased involvement with staff and OCERS' consultants, Meketa and PCA.

Ms. Chary presented an update on the rebalancing of the employer prepayments.

Ms. Freidenrich arrived at 9:11 a.m.

Mr. Ball, Ms. Chary and Mr. McCourt discussed the bond duration and bond sensitivity of these recent rebalancing trades.

Mr. Ball discussed OCERS' allocation between debt and equity, asking for the staff's and Meketa's rationale to allocate more to debt than equity.

Mr. McCourt responded that these recent transactions moved OCERS towards the likely long-term allocation targets. Further, he explained that the portfolio is underweight fixed income, so these rebalancing moves address that.

Mr. Ball, Mr. Lindholm and Ms. Chary discussed the current and prospective hedge fund portfolio and the timing of redemption proceeds.

Ms. Chary and Mr. Flanigan discussed overall expected cash flows for the upcoming year.

Ms. Chary provided an update on OCERS' Alternative Income RFP approved allocations to infrastructure funds, Argo Infrastructure Partners and BlackRock Global Renewable Power Fund II.

I-3 PORTFOLIO ACTIVITY REPORT
Presentation by Shanta Chary, DIO, OCERS & Stephen McCourt, CFA, Meketa

Ms. Chary presented the total fund overview, the preliminary performance, and asset allocation for December 2016. Ms. Chary also presented index returns as of January 22, 2017.

Mr. McCourt noted that OCERS' 2016 YTD performance places OCERS close to the top quartile of their peers. He briefly summarized that drivers of the relative strong performance included OCERS' U.S. equities allocation, specifically OCERS' energy allocation.

Ms. Chary also observed that U.S. small cap stocks contributed to OCERS' performance as small caps were positive outliers, strongly outperforming U.S. large cap stocks.

Mr. Packard and Ms. Chary discussed GMO.

Ms. Freidenrich and Ms. Chary discussed OCP Asia and the firm's performance.

Ms. Freidenrich, Mr. Prevatt, Ms. Chary and Mr. Ball discussed the possibility of a staff presentation on performance figures at June month-end and December year-end with updated manager returns received by those respective dates.

Mr. Prevatt suggested, addressing Ms. Freidenrich's and Mr. Hilton's concerns, that OCERS' performance reporting be agendized at a future Investment Committee meeting.

A **motion** was made by Mr. Baldwin and **seconded** by Mr. Hilton to receive and file I-3. The **motion carried unanimously.**

I-4 INVESTMENT BELIEFS STATEMENT
Presentation by Stephen McCourt, CFA & Laura Wirick, CFA, Meketa

Ms. Wirick presented OCERS' Investment Beliefs Statement. She described the revisions made to the Statement from prior Investment Committee meetings.

Ms. Wirick noted the revisions discussed by and sought from the Committee during the December 2016 Investment Committee meeting.

A **motion** was made by Mr. Ball and **seconded** by Mr. Packard to approve the Investment Beliefs Statement. The **motion carried unanimously.**

The Committee recessed at 10:04 a.m.

The Committee reconvened at 10:20 a.m.

I-5 ASSET ALLOCATION DISCUSSION
Presentation by Stephen McCourt, CFA & Laura Wirick, CFA, Meketa

Mr. McCourt presented OCERS' current asset allocation policy. To address staff's concerns regarding the absence of more asset allocation options for the Committee to review and discuss, Mr. McCourt presented an updated slide that included more mixes with a broader range of returns and standard deviations. He stated that no particular asset allocation is the correct one – each unique proposed policy represents an efficient market portfolio.

Mr. McCourt, using OCERS' Actuary, Segal's prior analysis, presented how each asset allocation policy could possibly perform during different market environments. He also described how those policies in different environments could affect employer contribution rates and OCERS' Unfunded Actuarial Accrued Liability (UAAL).

Mr. Hilton asked for the differences and similarities between Growth Risk Offset (GRO) and core fixed income.

Mr. Baldwin specifically asked for more education on GRO.

Mr. Hilton observed that many of the market scenarios discussed by OCERS and Meketa incorporated more bear market scenarios versus bull ones. He asked for the possible opportunity costs to OCERS' portfolio in response to bull market environments.

Mr. McCourt discussed the possible opportunity cost of each asset allocation policy in various positive market environments.

Mr. Ball, Ms. Freidenrich, and Mr. McCourt discussed the mathematical asymmetry in percentage gains and loss, specifically the challenge in recovering losses incurred during drawdown periods.

Mr. McCourt explained the short-term consequences of volatility and drawdowns, and its impact on interim contribution rates.

Mr. Gilbert arrived at 10:58 a.m.

Mr. Hilton stated his asset allocation preference for more exposure to GRO and less fixed income.

Mr. McCourt responded that this part of the asset allocation exercise is effectively part 1, with broad modelling and ranges of each asset class. He stated that the next step would involve an in-depth analysis of each underlying asset class.
Mr. McCourt summarized GRO and its similarities and differences to fixed income, particularly how GRO behaves in differing interest rate regimes.

Ms. Freidenrich asked for Meketa's recommended asset allocation policy for OCERS.

Mr. McCourt initially responded by stating Meketa's continued support for GRO, with a 5-10% initial allocation, and longer-term, perhaps a higher GRO allocation given certain market conditions. He noted Meketa's recommendation is for any of the policies with standard deviations ranging from 11.5% to 13.8%, given that each are reasonable asset allocation policies.

Mr. Baldwin, Mr. Flanigan, and Mr. McCourt discussed trend-following managers, which is a subset of GRO. Mr. McCourt discussed performance of these managers in low-volatility, mean-reverting markets versus high volatility markets, and how these managers contribute diversification benefits to OCERS' portfolio. He observed that these managers tend to underperform in most markets, but should do well in challenging markets.

Mr. Emkin discussed actuarial rates and the challenge of meeting liabilities during market sell-offs, stating that regardless of market performance, liabilities continue to grow at the actuarial assumed rate. He discussed GRO and the rationale behind it, which is to diversify against the portfolio's growth risk. GRO is comprised of long treasury bonds, but also includes strategies that are complimentary to long treasury bonds.

Mr. Ball noted that bonds have benefitted from a secular bull market since the 1980s and questioned how much GRO has benefitted from such a market, as well as how GRO would perform during a bond bear market.

Mr. Emkin responded that GRO includes other strategies that it is not largely dependent on interest rate risk and would serve to diversify the portfolio.

Mr. McCourt suggested a possible perspective would be for the Committee to look at the core fixed income allocation and GRO as one collective asset class.

Mr. McCourt also explained that no one asset class works well all the time and suggested against high portfolio turnover, which oftentimes equates into buying tops and selling bottoms.

Mr. Hilton commented that OCERS, being cashflow positive, is unique relative to other plans. He opined that OCERS has not sufficiently capitalized on this benefit.

Mr. McCourt responded that OCERS benefits from positive cashflows with its ability to buy and hold a higher illiquid allocation, which has higher risks, as well as higher expected returns.

Mr. Eley stated that OCERS historically has not taken advantage of U.S. equities, citing OCERS' tendency to focus only on large drawdowns, overlooking that historically there has been more positive markets versus negative ones. He explained, however, that it is not his intention to materially increase equity exposure right now, but to select the appropriate asset allocation policy that affords OCERS the flexibility to capitalize on private and public equity market dislocations, i.e., post 2002 and post 2008.

A **motion** was made by Mr. Hilton and **seconded** by Mr. Ball to select the new asset allocation policy with a standard deviation of 13.0% and a risk mitigation allocation.

Mr. Delaney observed that this motion to recommend the 13.0% asset allocation policy is actually the one recommended by the staff as well.

Mr. Baldwin stated his preference for the policy with a standard deviation of 13.8% because of its higher equity allocation. However, he expressed caution due to the higher risk involved and would vote for the 13.0% policy due to the flexibility and ability to gradually increase OCERS' equity allocation.

Mr. Flanigan expressed disagreement with a higher equity allocation.

Mr. Ball commented that the Committee is only setting the policy targets right now and that during the 2nd stage of the asset allocation process, the Committee will then determine the wanted asset class allocation ranges around those targets.

Ms. Freidenrich expressed her disagreement with the 13.0% standard deviation policy, citing support for the 12.2% standard deviation asset allocation policy recommended in October 2016.

Mr. Lindholm, Mr. Ball, and Mr. McCourt discussed the timetable in the actual implementation of the approved asset allocation policy, particularly given the absence of a CIO.

Mr. Emkin proposed that staff and consultants present a possible asset allocation schedule, citing that clients tend to always buy an asset class at market peaks.

Mr. Packard observed that OCERS historically has been too conservative, as their asset allocation policy was inflexible, preventing OCERS from exploiting equity market sell-offs. He noted the importance of being ready to deploy and not miss these rare opportunities.

A **substitute motion** was made by Mr. Flanigan and **seconded** by Ms. Freidenrich to select the asset allocation policy with a 12.2% standard deviation. The **motion failed 3-6** with voting as follows:

AYES	**NAYS**	**ABSTAIN**	**ABSENT**
Mr. Flanigan	Mr. Packard		
Ms. Freidenrich	Mr. Baldwin		
Mr. Lindholm	Mr. Eley		
	Mr. Hilton		
	Mr. Ball		
	Chair Prevatt		

The **original motion** made by Mr. Hilton and **seconded** by Mr. Ball to select the new asset allocation policy with a 13.0% standard deviation and a risk mitigation allocation **carried 6-3** with voting as follows:

AYES	**NAYS**	**ABSTAIN**	**ABSENT**
Mr. Packard	Mr. Flanigan		
Mr. Baldwin	Ms. Freidenrich		
Mr. Eley	Mr. Lindholm		
Mr. Hilton			
Mr. Ball			
Chair Prevatt			

The Committee recessed for lunch at 12:00 p.m.

Mr. Hilton left at 12:00 p.m.

The Committee reconvened at 12:48 p.m.

I-6 CURRENCY HEDGING
Presentation by Stephen McCourt, CFA & Laura Wirick, CFA, PCA

Mr. McCourt provided a brief summary of OCERS' currency hedging transactions, specifically the original rationale for the yen and euro hedges, as well as the performance, risks, and costs associated with those hedges.

Mr. McCourt stated that Meketa's recommendation is to unwind both hedges immediately.

Mr. Prevatt asked about the operational mechanics behind unwinding OCERS' euro and yen hedges.

Mr. McCourt responded that the currency markets are very liquid and operationally it would be easy to unwind the euro and yen trades.

Mr. Ball and McCourt discussed the original currency price targets for each of the currencies.

Mr. McCourt reported that Meketa's recommendation was to unwind these hedges because of their belief that the Committee should focus on long-term strategic decisions that are likely to materially impact the portfolio.

Mr. Prevatt also noted the difficulty in continuing this hedging program without a CIO in place.

A **motion** was made by Mr. Flanigan and **seconded** by Mr. Ball to unwind the euro and currency hedges. The **motion carried unanimously.**

I-7 CIO CHARTER AND INVESTMENT POLICY STATEMENT REVIEW
Presentation by Steve Delaney, CEO, OCERS

Mr. Delaney presented OCERS' current CIO Charter and Investment Policy Statement. He described revisions to the CIO Charter and Investment Policy Statement approved during OCERS' former CIO, Girard Miller's tenure. He also presented proposed amendments to the CIO Charter and the Investment Policy Statement that he and OCERS' consultants recommended.

Mr. Ball stated that the CIO reports to the CEO and suggested that these proposed amendments need to be ultimately be approved and supported by OCERS' CEO.

Mr. Delaney expressed agreement.

Mr. Delaney reported that an Ad Hoc Committee will be used to assist in the search for a new CIO. Similar to recently used Ad Hoc Committees, he stated that Chair Prevatt, Mr. Ball, and Mr. Hilton would be part of this committee.

A **motion** was made by Mr. Ball and **seconded** by Mr. Flanigan to accept the recommended amendments to the CIO Charter and Investment Policy Statement. The **motion carried unanimously**.

*** * * * *END OF INDIVIDUAL ITEMS AGENDA * * * * ***

PUBLIC COMMENTS: At this time members of the public may address the Committee of Retirement regarding any items within the subject matter jurisdiction of the Committee, provided that no action may be taken on non-agendized items unless authorized by law.
None

COMMITTEE MEMBER COMMENTS
None

CHIEF EXECUTIVE OFFICER/STAFF/CONSULTANT COMMENTS
Ms. Chary provided an update on OCERS' investment in London-based Park Square. She also reported that Mr. McCourt, while he was in Europe, visited with Park Square.

Mr. McCourt stated despite recent news, he remarked the following: there is no impact on OCERS' portfolio; Meketa is not concerned, but they will continue to monitor the situation and the fund.

COUNSEL COMMENTS
None

ADJOURNMENT:
The Chair adjourned the meeting at 1:03 p.m.

Submitted by:

Steve Delaney
Secretary to the Committee

Approved by:

Chris Prevatt
Chair