

ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM

**BOARD OF RETIREMENT
2223 E. WELLINGTON AVENUE, SUITE 100
SANTA ANA, CALIFORNIA**

**INVESTMENT MANAGER MONITORING
SUBCOMMITTEE MEETING**

**June 7, 2018
9:00 A.M.**

MINUTES

The Vice Chair called the meeting to order at 9:04 a.m. and read the opening statement into the record. Attendance was as follows:

Present: Charles Packard, Chair; Russell Baldwin, Vice Chair; Shawn Dewane; and Frank Eley

Also present: Brenda Shott, Assistant Chief Executive Officer; Molly Murphy, CFA, Chief Investment Officer; David Beeson, Investment Officer; Tarek Turaigi, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Julius Cuaresma, Investment Analyst; Anthony Beltran, Visual Technician; and Brittany Cleberg, Recording Secretary

I. INDIVIDUAL MANAGER PRESENTATIONS

Mr. Beeson provided a brief reminder of the new format to the Investment Manager Monitoring Subcommittee (IMMS) meetings: the IMMS will now have at least three managers present at each quarterly IMMS meeting. This compared to monthly IMMS meetings, where two-three managers presented and every manager presented on a two to three year cycle. Staff will now bring in managers to each meeting that are on exception; specifically, presenting managers will likely either be: (1) on watch list, underperforming managers, and/or managers who have a material change at the organization level; or (2) outperforming managers and/or managers who have continued opportunities in their target universe.

Mr. Packard arrived at 9:05 a.m.

Mr. Beeson discussed the day's presenting managers: (1) BlueBay's Emerging Market Debt (EMD) strategy is presenting due to underperformance, as well as a change in their organization; EMD's key portfolio manager, David Dowsett, is transitioning to more of a strategic, top-down role; (2) Mondrian Investment Partners (Mondrian) is presenting due to underperformance; (3) Capital Group (Capital) is presenting due to strong outperformance on all trailing time periods.

Mr. Beeson introduced BlueBay, who manages \$276.6 million on behalf of OCERS in a blended hard currency (HC)/local currency (LC) EMD strategy within the credit asset class. OCERS' inception date with BlueBay is March 2013. BlueBay can dynamically change the mix of HC and LC and consequently, the portfolio will not always match the 50% HC/50% LC benchmark - as of April 2018, the portfolio was approximately 47% HC/47% LC, with the balance in cash.

Mr. Beeson discussed Mr. Dowsett's transition, while also noting that Emerging Market Select Bond Fund will therefore be managed by Russel Matthews and Nick Shearn only. Russel Matthews, who has been working jointly as portfolio manager in investment grade and EM,

moved to the EM team at the onset of 2017. He reported that BlueBay's performance had since improved.

Mr. Eley, Mr. Beeson, and Ms. Murphy discussed possible drivers of such performance improvement, correlation versus causation, as well as tailwinds to EMD's performance in 2017, and recent headwinds in 2018.

Mr. Baldwin, Mr. Eley, Ms. Murphy, and Mr. Beeson discussed BlueBay's macro research efforts, particularly as it relates to BlueBay's ability to profitably navigate country-specific political and economic risk factors.

Mr. Packard and Ms. Murphy discussed Pictet, OCERS' other EMD manager.

Ms. Murphy also indicated that staff would review the EMD asset class as a whole, its role, and risk-return expectations within the context of OCERS' entire portfolio.

Ms. Murphy discussed LC and HC, the difficulty in finding good bonds, and the challenges in profitably timing the correct mix of LC and HC.

Mr. Baldwin, Ms. Murphy, and Mr. Beeson discussed OCERS' current Watch List, and potential candidates for Watch List, including BlueBay and Mondrian.

BLUEBAY ASSET MANAGEMENT

Presentation by Russel Matthews & Tomas Martin, CFA

The key highlights of the presentation were:

Firm update: As of the end of April 2018, Bluebay's assets under management were just north of \$60 billion. The manager continued the discussion on the organizational changes, including Polina Kurdyavko, Partner, now the sole head of the EMD team – she has been at BlueBay since 2005 and co-head of the team since 2014. The manager also noted that BlueBay would be adding a currency specialist within the next month.

Portfolio Strategy: The manager seeks to capitalize on EM inefficiencies. The manager fundamentally believes that underlying EM sovereigns are improving relative to developed markets. The manager's strategy is advanced through fundamental analysis (of local rates, FX, sovereign credit-worthiness), valuation (of economic and political factors relative to spreads), and portfolio construction (time-arbitrage between short, medium, and long-term views). The manager's investment allocations on local debt and currency are separate investment decisions. The manager dynamically hedges through credit default swaps and risk-mitigation currency strategies.

Market Overview/Outlook for 2018: The synchronization in global growth has benefitted risk assets, particularly EM. However, the manager is cognizant of increasing headwinds to their strategy, particularly threats to free global trade, rising rates in the U.S., and pockets of populism around the globe that could fracture political and socio-economic stability.

Performance: As of April 30, 2018, BlueBay returned 6.4% net of fees over the last 12 months versus the 50% JPM EMBI Global Diversified Index/50% JPM GBI EM Global Diversified Index return of 4.8%. Over the past three years, the manager returned 3.1%, lagging the index by 1.1%.

Mr. Packard and Mr. Matthews discussed Argentina, the country's current challenges, and the prospective Argentinean opportunity set for BlueBay.

Mr. Baldwin and Mr. Matthews discussed idiosyncratic country risk, particularly as it concerns Argentina and Turkey.

Mr. Baldwin, Mr. Eley, and Mr. Matthews discussed BlueBay's team structure and responsibilities, specifically as it relates to the recent organizational changes, and the recent outperformance.

Mr. Matthews further described that the BlueBay team is more policy-focused, on a country-by-country basis. He reported that BlueBay still analyzes economic risk factors, but also evaluates each country's political cycles. He also described BlueBay's 360 comprehensive view in analyzing opportunities, as the manager not only incorporates the analyst team's perspective, but also their execution traders' perspective. He explained that while there has been process improvements, he also emphasized upon the team's continued focus on collaboration and his seamless transition in this new but similar role, given he has been at BlueBay since 2010.

After further discussion, the Committee supported recommending BlueBay for Watch List.

The Committee recessed at 10:03 a.m.

The Committee reconvened at 10:18 a.m.

MONDRIAN INVESTMENT PARTNERS LIMITED

Presentation by Aidan Nicholson, CFA & Paul M. Ross, CFA

Mr. Beeson introduced Mondrian, who manages \$160.2 million on behalf of OCERS in an active international small cap equity mandate. He noted that the manager's value investment style has been out of favor in this growth and momentum oriented bull market. Mondrian returned 8.5% and 7.3% over the trailing three and five years, lagging its benchmark, the MSCI World Ex-US Small Cap by 1.6% and 2.1%, respectively. Given the manager's value orientation, he compared Mondrian to more suitable index, the MSCI World Ex-US Small Cap Value Index; he reported that this Value Index has marginally outperformed Mondrian by 0.2% and 1.2% over the trailing three and five years, respectively.

Mr. Baldwin asked if there is a complementary manager in OCERS' portfolio.

Mr. Beeson responded that Fidelity manages a core international small cap strategy on OCERS' behalf; given its core strategy, he also reported that this manager, formerly known as Pyramid, has unsurprisingly outperformed its benchmark.

Ms. Murphy reported upon her experience investing with Mondrian, explaining the cyclical nature of the manager's performance. She observed that, as with any other manager, there are periods where the manager's investment style may fall in and out of favor, i.e., periods of drought and of harvesting – the particular issue with Mondrian is whether their investment process and team remains consistent and intact.

The key highlights of the presentation were:

Firm update: Mondrian manages approximately \$60 billion, with approximately \$7 billion in their international small cap strategy.

Portfolio Strategy: The manager employs a proprietary inflation-adjusted dividend-discount model to evaluate their international ex-U.S. small cap universe. The goal of this long-term purchasing power parity approach is to facilitate OCERS in meeting its ongoing and future liabilities. Mondrian seeks companies with a sustainable cash flow, high barriers to entry and strong balance sheets.

Market Overview/Outlook for 2018: Accommodative global monetary policy and the excess liquidity in the markets have been headwinds to the manager's value orientation and defensive portfolio positioning. The manager expects such monetary policy to gradually normalize. The manager also observed their increased effort to carefully navigate countries, sectors, and names that are more susceptible to political risk.

Performance: The manager continued the earlier discussion regarding Mondrian's underperformance. They also noted that while Mondrian is expected to lag on the upside, the manager, too, should outperform, i.e., protect better on the downside; further, Mondrian's inherent defensive philosophy generates a steadier, less volatile return stream that its benchmark, with a historical standard deviation of 10.6% versus 11.8%.

Mr. Baldwin and Mr. Nicholson discussed the energy complex, particularly coal. They also discussed energy renewable and sustainable opportunities that Mondrian has capitalized on.

Mr. Baldwin and Mr. Nicholson discussed Mondrian's positioning in Japan and Singapore. They also discussed China, particularly as it concerns the opening of the China A-share markets.

Mr. Eley and Mr. Nicholson continued the discussion on Japan, as well as Brexit and its economic impact on England.

Mr. Packard and Mr. Nicholson discussed Mondrian's currency hedging, including Mondrian's New Zealand hedge.

Mr. Baldwin and Mr. Nicholson also discussed Mondrian's view on the USD.

Mr. Packard and Mr. Nicholson discussed Mondrian's exposures to Hong Kong and China.

Mr. Nicholson further explained that Mondrian's Hong Kong/China investments are all listed in Hong Kong.

Ms. Murphy described that Mondrian's defensive and value philosophy needs volatility and choppy markets to generate returns.

After further discussion, the Committee supported recommending Mondrian for Watch List.

Mr. Packard and Ms. Murphy discussed the possible duration for the manager on Watch List.

The Committee recessed at 11:12 a.m.

The Committee reconvened at 11:28 a.m.

CAPITAL GROUP

Presentation by Gerald Du Manoir & Michael A. Bowman

Mr. Beeson introduced Capital Group (Capital), who has managed capital on OCERS' behalf, currently \$304.9 million, through an international equity mandate since 1989.

Firm update: As of the end of December 2017, Capital's assets under management were approximately \$1.8 trillion. Capital remains privately held.

Portfolio Strategy: Capital is a bottoms-up, fundamental research oriented firm that uses a multiple portfolio manager system (MPMS) to identify investments. This MPMS investment process is supported by analysts and their "research portfolio." This portfolio empowers the analysts to be portfolio managers and instills in the analysts the value of portfolio construction and position conviction. The research portfolio represents approximately 20% of the entire portfolio.

Market Overview/Outlook for 2018: The manager observed that although their holding period is generally three to five years, in this market environment, the fuse is shorter when things do not go well – therefore, Capital may be quicker to trim and/or exit losses more quickly.

Performance: The manager has generated strong returns, outperforming its benchmark, MSCI EAFE Index, over all trailing time periods. Over the last 12 months, Capital has produced a net return of 16.7%, versus 14.5% for its benchmark.

Mr. Eley, Mr. Bowman, and Mr. Manoir discussed the rationale for Capital's outperformance.

Mr. Bowman attributed Capital's outperformance to Capital's culture and the importance the firm has placed on human capital. Capital's high retention rate is largely due to their MPMS; he explained that MPMS empowers analysts to be both portfolio managers and analysts, which analysts generally would not benefit from at other investment management firms.

Mr. Manoir further explained a number of factors for their outperformance, including Capital's low 30% portfolio turnover rate and their long-term three-year view on stock selection.

Mr. Eley and Mr. Manoir discussed Capital's underperformance from 2005 – 2010; this included a discussion on Capital's reduction in portfolio managers with fewer mandates.

Mr. Baldwin and Mr. Manoir discussed the global energy complex; this included a discussion on the growing profitability of alternative energy sources without the support of governments.

Mr. Dewane observed that Capital's MPMS also inherently imparts "skin in the game" to the analyst team; he also opined that Capital's active management should bode well in the current and prospective market environment.

Mr. Dewane asked for Capital's other investment strategies.

Mr. Manoir responded, briefly discussing Capital's lower volatility strategies.

Mr. Bowman responded, briefly discussing Capital's factor-based strategies, as well as multi-asset strategies.

Mr. Dewane and Ms. Murphy discussed OCERS' investment managers and their capability to share their analytical tools and resources with staff.

Ms. Murphy reported that staff has and will continue to leverage managers' resources.

PUBLIC COMMENTS:

None

COMMITTEE MEMBER/STAFF COMMENTS:

Mr. Dewane reported and commented upon his attendance at his firm's national conference for professional development. He attended sessions on how to be a better fiduciary and a session on ESG investing. He will report back to the full board regarding the conference.

Mr. Baldwin reported and commented upon his attendance at the US FIS conference.

ADJOURNMENT:

The Chair adjourned the meeting at 12:12 p.m.

Submitted by:



Brenda Shott
Secretary to the Committee

Approved by:



Charles Packard
Chair