

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

**INVESTMENT COMMITTEE MEETING  
August 30, 2018**

**MINUTES**

Attendance was as follows:

Present: Wayne Lindholm, Chair; Frank Eley; Vice Chair; Charles Packard; Chris Prevatt; Jeremy Vallone; Roger Hilton; David Ball; Russell Baldwin; and Shari Freidenrich

Absent: Shawn Dewane

Also Present: Steve Delaney, Chief Executive Officer; Molly Murphy, CFA, Chief Investment Officer; Shanta Chary, Director of Investment Operations; David Beeson, Investment Officer; Tarek Turaigi, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Julius Cuaresma, Investment Analyst; Gina Ratto, Chief Legal Officer; Anthony Beltran, Visual Technician; and Brittany Cleberg, Recording Secretary

Almanac Real Estate Investors: Matthew Kaplan and Josh Overbay  
Meketa Investment Group: Stephen McCourt, CFA and Laura Wirick, CFA, CAIA  
PCA: Allan Emkin and Colin Beebe, CFA  
Schroders: Azad Zangana  
Townsend Group: Robert Miranda and Felix Fels

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

**CONSENT AGENDA**

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

A **motion** was made by Mr. Ball and **seconded** by Mr. Eley to pull the Consent Agenda. The **motion carried unanimously.**

**C-1 COMMITTEE MEETING:**

**Approval of Meeting and Minutes**

Investment Committee Meeting

July 26, 2018

**Recommendation:** Authorize meeting and approve minutes.

Mr. Ball pulled the July 26, 2018 Investment Committee Meeting minutes, citing his concerns relating to the minutes recorded for agenda item I-4 Manager Activity, particularly page 5. He opined that the minutes for this particular section did not accurately reflect the concerns of Committee members, specifically the concerns of Mr. Eley, Mr. Packard, and Ms. Freidenrich, regarding OCERS' delegated authority process.

Mr. Ball recalled that the discussion amongst the Committee and staff included more direction to staff: organize all the concerns of the Committee and work with the Committee on sufficient reporting and presentation of Manager Activity such that all of the Committee's concerns are addressed. He expressed the need for delegated authority to have a philosophy and parameters in place.

Mr. Ball summarized that although he was a strong proponent of delegated authority, ultimately his concern is that the CIO is committing to new investments without a proper delegated authority process. He also noted his concern about fees, particularly as it relates to catch-ups.

***Ms. Freidenrich arrived at 9:10 a.m.***

Ms. Freidenrich opined, believing that Mr. Delaney stated and summarized that staff would come back to the Committee with a detailed Manager Activity report. She also expressed that she was not too concerned about formatting.

Mr. Delaney observed that staff, with direction from the Committee, can come back to the Committee.

Mr. Delaney suggested that the Committee can request to bring back the July 26, 2018 Investment Committee minutes with clearer, more precise language, and/or agendaize the Manager Activity summary to address the Committee's concerns, particularly the reporting process.

Mr. Lindholm asked whether these delegated authority reporting issues were discussed during the policy charter discussions earlier in the year.

Ms. Murphy responded that staff, for this meeting, attempted to address the Investment Committee's Manager Activity concerns from the prior month's Committee meeting. In particular, staff attempted to capture, within the new Manager Activity summary template, now called the Manager Terminations & Selections Report, fees relative to the market, and should fees be out of synch with the market, the driving forces behind such a move away from the market. She observed that historically OCERS had a fee policy, but that policy left many questions unanswered and that that the language around fees was now part of the IPS. She also observed that historically and currently OCERS' charters left the authority and purview of fee negotiations to the CIO.

Mr. Baldwin noted that though this discussion was supposed to be about the lack of clarity in the July 26, 2018 Investment Committee meeting minutes, even taking the minutes for this discussion would be challenging. He rationalized that the minutes discussion should be separated from the discussion regarding the CIO's and the Committee's policy responsibilities.

Mr. Ball noted that the Committee needs to clarify tasks and direct staff accordingly. He discussed fees, noting that Ms. Murphy was correct, as fees and terms can and will fluctuate. That said, he suggested that maybe OCERS should pass on some deals. He continued to express the need for a fee philosophy and framework, so that staff has guidance. Further, he explained that with a clearer framework, staff would know the distinction when fees are in-line with OCERS' standards; when they are not in-line, staff would be required to bring the investment back to the Committee for approval.

Mr. Ball also expressed agreement with Mr. Baldwin's comments regarding separating the minutes discussion and discussion regarding the CIO's and the Committee's policy responsibilities.

Mr. Lindholm noted that the July 26, 2018 Investment Committee Meeting minutes and a discussion of Manager Activity Summary reporting and the related process would be agendaized.

Mr. Prevatt stated the minutes are a summary of what occurred, and not a detailed transcript. He suggested that the Committee be careful not to direct staff to create a detailed transcript of meetings.

A **motion** was made by Ms. Freidenrich and **seconded** by Mr. Ball to move the approval of the July 26, 2018 Investment Committee Meeting minutes to the October 25, 2018 Investment Committee Meeting. The **motion carried unanimously.**

Mr. Ball asked that fee guidelines and policies be discussed at the October 25, 2018 Investment Committee Meeting. He again continued to express the need for a fee philosophy and framework, so that staff has the flexibility to move with the market – further, if staff needs or wants to be out of sync with the market, staff needs to have the ability to come back to the Committee for approval. He stated that the Committee would not necessarily deny the investment, but rather, there needs to be a discussion.

Ms. Freidenrich expressed agreement with Mr. Ball's comments.

Ms. Freidenrich, Ms. Murphy, and Mr. Delaney discussed OCERS' prior fee philosophy. Both Mr. Delaney and Ms. Murphy confirmed that the Board incorporated the fee philosophy into the Investment Policy Statement earlier in the year.

Mr. Lindholm and Mr. Delaney noted that this fee discussion would come back at the October meeting due to the September Annual Strategic Planning Meeting.

Mr. Prevatt expressed confirmation that delegated authority still exists; he warned against the appearance that the Committee, during this consent agenda discussion originally intended to review the accuracy of the July 26, 2018 Investment Committee Meeting minutes, somehow evolved into a discussion of fees under the purview of the CIO and of delegated authority as a whole. He expressed concern that this discussion, one that now appeared to question and possibly remove delegated authority, is not agendaized for discussion.

Mr. Ball and Mr. Prevatt discussed whether or not the Board-approved delegated authority has guidelines.

Mr. Prevatt stated that the delegated authority does include guidelines while Mr. Ball expressed disagreement.

Mr. Ball further expressed that the current delegated authority process is completely different, noting that it has completely devolved from what he originally voted and approved. He stated that he expected more details, particularly with regards to reported upon fees and risks associated with forthcoming investments. Further, he believed that delegated authority would require an Investment Committee vote prior to Ms. Murphy proceeding with any subscription or redemption.

Mr. Prevatt expressed disagreement, observing that was not agreed upon.

Mr. Ball stated that he would not have voted his approval on delegated authority as it currently stands.

Mr. Packard stated that Ms. Murphy is only accountable if she has parameters and guidance set forth from the Committee. He observed that there are several variable definitions of her performance; he noted that it would be beneficial for all if there is a standardized form that Ms. Murphy prepares and provides to the Committee so the Committee can see Ms. Murphy's interpretation of the guidance that the Committee has provided to her. He opined that this is a process and is only a bump in the road that has provided a good learning experience for all.

Mr. Packard also stated that OCERS cannot change every investment vehicle according to OCERS' needs, i.e., there will be situations where OCERS will be a deal taker, rather than a deal setter.

Mr. Lindholm recalled that earlier in the year, the Committee, though it was not a unanimous decision, voted and approved of delegated authority within the IPS/CIO. Post that approval, in order to reflect some of the Committee's concerns, principally Mr. Ball's and Ms. Freidenrich's, the Committee modified the IPS and CIO charter several times. He noted that he is fine if the Committee wants to modify the respective policies and charters again, but he stated that he does not want the impression that Ms. Murphy does not have the directive and authority to proceed with making investment commitments.

Mr. Baldwin observed that many of the Trustees have stated what role and responsibilities Ms. Murphy has under delegated authority – he expressed his desire to know what role and responsibilities Ms. Murphy believes she has.

Mr. Prevatt interjected, noting that the Committee is way off of the Investment Committee Agenda. He asked Ms. Ratto if the Committee has strayed away from the Investment Committee Agenda.

Ms. Ratto responded by first noting that she believed that the Committee had strayed away from the Investment Committee Agenda and that this delegated authority discussion should be agendaized for a future Investment Committee Meeting. However, she expressed concern that some of the Committee members believe that Ms. Murphy does not have the delegation that Ms. Murphy believes she has.

Mr. Delaney observed that the Committee had pulled the Investment Committee Meeting minutes, which was agendaized for discussion; however, he questioned if this minutes discussion was basis enough for this directional discussion and asked for Ms. Ratto's clarification.

Ms. Ratto responded, stating her belief that she does not think the Committee is talking about the Investment Committee Meeting minutes anymore. Rather, she believed the Committee is now discussing what the Committee did long before the July 26, 2018 Investment Committee Meeting minutes.

Mr. Delaney observed the gravitas of this discussion and did not want today's meeting to proceed without a clear direction for Ms. Murphy. Mr. Delaney discussed the option, under the Brown Act, to vote on a non-agendaized item with three fourths of the Committee's vote approval.

Ms. Ratto expressed concern, explaining that the Committee and staff might not be prepared for such a robust discussion.

Mr. Ball stated that neither he nor Ms. Freidenrich had proposed a motion to change delegated authority. Rather, he stated that he is just talking about the July 26, 2018 Investment Committee minutes, specifically the minutes that talked about the process, and talking about bringing back the process and until the process is changed or modified, Ms. Murphy has the authority that the

Committee approved of earlier in the year. He stated he did not know what that authority is exactly, and requested a copy of what Ms. Murphy believes she is operating under.

Mr. Delaney stated that the copy will be sent to the entire Investment Committee.

## **CIO COMMENTS**

None

## **ACTION ITEMS**

**NOTE:** Public comment on matters listed in this agenda will be taken at the time the item is addressed, prior to the Committee's discussion of the item. Persons wishing to address items on the agenda should provide written notice to the Secretary of the Committee prior to the Committee's discussion on the item by signing in on the Public Comment Sign-In Sheet located at the back of the room.

### **A-1 INDIVIDUAL ACTION ON ANY ITEM TRAILED FROM THE CONSENT AGENDA**

## **INFORMATION ITEMS**

### **I-1 QUIET PERIOD - INVESTMENT RELATED SEARCHES**

Written report only

### **I-2 INVESTMENT COMMITTEE COMMUNICATIONS**

Written report only

### **I-3 MEKETA ECONOMIC OUTLOOK**

Written report only

### **I-4 REAL ESTATE PRESENTATION**

*Presentation by Matthew Kaplan & Josh Overbay, Almanac Real Estate Investors*

Ms. Murphy provided background information regarding the rationale for the presentation. She remarked that at the July 26, 2018 Investment Committee meeting, the OCERS staff, and the Townsend Group discussed the \$75 million commitment to Almanac Realty Securities Fund VIII (ARS VIII). In light of Almanac's differentiated real estate strategy relative to typical OCERS' real estate investments, the Committee had outstanding questions that suggested further insight directly from Almanac. Accordingly, Ms. Murphy introduced Mr. Kaplan, Managing Partner, and Mr. Overbay, Managing Director.

Mr. Kaplan provided a brief history of Almanac, while also describing Almanac's opportunity set and what differentiates Almanac from other real estate investment managers.

Mr. Overbay provided an update on Almanac's fundraising activities. He also discussed Almanac's fee structures, including a discussion on how their structure is aimed at mitigating j-curve issues.

Mr. Eley, Mr. Ball, and Mr. Kaplan discussed Almanac's performance track record and the manager's use of leverage.

Mr. Kaplan observed that Almanac is not a core real estate manager. He described that relative to core, Almanac is more levered; he also reported that relative to value-add, Almanac is not more levered.

Mr. Lindholm and Mr. Kaplan discussed Almanac's track record, particularly in 2007 – 2008, and how cap rates have affected how Almanac has historically invested.

Mr. Kaplan discussed investment management company's personal capital commitments.

Mr. Packard and Mr. Kaplan discussed Almanac's fee structure and compensation scheme for their employees.

Mr. Packard and Mr. Kaplan discussed how Almanac grows the company's equity value.

Mr. Kaplan responded, noting equity value is increased in the following ways: 1. Appreciation in the underlying real estate; 2. Participation in the increase in real estate value through their ownership in the real estate company, e.g., common equity, warrants.

Mr. Packard and Mr. Kaplan discussed possible liquidity events.

Mr. Packard and Mr. Kaplan discussed Almanac's involvement as Board members on the underlying investment management companies they have transacted and invested in.

Mr. Kaplan responded that Almanac is very involved as Board members: Almanac has made capital structure and budgeting decisions as well as hire/fire senior executive; they have also reviewed quarterly reports for variance analysis.

Mr. Packard and Mr. Kaplan discussed Almanac's audit process.

Mr. Ball and Mr. Kaplan discussed how Almanac calculates their leverage structure.

Mr. Ball and Mr. Kaplan discussed the typical deal structure between Almanac and the sponsor.

Mr. Ball and Mr. Kaplan discussed Almanac's approval rights as Board members concerning major decisions.

Mr. Ball and Mr. Kaplan discussed possible restrictions regarding how many private vs. public transactions that Almanac can do, as well as if there are any restrictions regarding cash flow coverage on deals.

Mr. Ball and Mr. Kaplan continued the Committee's earlier discussion concerning Almanac's performance fee structure.

Mr. Kaplan and Mr. Overbay responded that Almanac uses a European waterfall structure, i.e., the preferred return threshold is calculated at the fund level, rather than the American waterfall, i.e., the preferred return threshold is calculated for deal-by-deal. They summarized the European structure is more LP-friendly.

Mr. Ball expressed his overall concern is that an investment in Almanac is part real estate and part private equity.

Mr. Ball and Mr. Kaplan discussed Almanac's valuation process and frequency.

Mr. Kaplan reported that Almanac's properties are valued quarterly and are valued property by property, rolled up into a NAV, which informs NAV/share. Further, he explained there is no multiple, no public comparisons, etc., that would normally be used to value private equity deals.

Mr. Ball, Mr. Packard, and Mr. Kaplan discussed reporting requirements and standards.

Mr. Kaplan confirmed that Almanac is an investment manager that manages funds, and not a real estate company, so Almanac has to report fair market value.

Ms. Freidenrich, Mr. Kaplan, and Mr. Overbay discussed the number of open/closed Almanac funds.

Ms. Freidenrich and Mr. Kaplan discussed Almanac's staffing needs as it relates to prior smaller funds and newer larger funds. They also discussed Almanac's compliance team.

Ms. Freidenrich and Kaplan discussed Almanac's compliance team.

Mr. Kaplan noted the importance of compliance to Almanac, noting that historically he himself was Chief Compliance Officer.

Ms. Freidenrich and Mr. Overbay discussed Almanac's re-up rate.

***The Committee recessed at 10:37 a.m.***

***The Committee reconvened at 10:45 a.m.***

#### **I-5 EUROPEAN ECONOMIC DISCUSSION**

*Presentation by Azad Zangana & Allan Duckett, Schroders*

Ms. Murphy introduced Mr. Zangana and Mr. Duckett of Schroders, a European-based, multi-national, multi-asset management firm. Ms. Murphy noted that while OCERS has a core U.S. fixed income allocation to Schroder's Value Core Strategies, Mr. Zangana, a Senior European Economist and Strategist at Schroders, will discuss the current European economic backdrop. In particular, Mr. Zangana presented the macro and micro themes affecting not just Europe, but also the direct and indirect ways those themes are impacting the rest of the global economy.

#### **I-6 2017 FEE REPORT**

*Presentation by Molly A. Murphy, CFA, CIO, Shanta Chary, DIO, & Stina Walander-Sarkin, IA, OCERS*

Ms. Murphy provided background information on the 2017 Fee Report. She described that staff, in addition to normally reporting on fees, has also increasingly worked on the structure of OCERS' fees, i.e., formulating a comprehensive OCERS fee philosophy. At the July meeting, the committee had mentioned the desire to have more information provided by staff regarding its fee philosophy which this presentation details.

Ms. Murphy noted the importance of demarcating strategies and asset classes where OCERS is a fee taker vs. fee setter.

Ms. Walander-Sarkin noted the 2017 fee reduction relative to 2016 largely derived from hedge fund and GTAA terminations. She provided various fee breakdowns, including passive vs. active, as well as actual dollar allocation of passive vs. active managers. She described outliers and trends, including 3-year fee trends for specific asset classes relative to peer averages (public funds over \$5 billion).

Mr. Eley asked about private equity fund-of-fund fees, specifically management fees and management fees for OCERS' peer group.

Ms. Walander-Sarkin responded that that OCERS' fund-of-fund management fees were slightly below 150 bps.

Ms. Murphy also responded, reporting that the survey was done for pension funds north of \$5 billion; she also observed that it is rare for pensions of that size to have a prevalent use of a fund-of-fund allocation.

Mr. Ball observed from the presentation that though the dollar allocation between passive and active management is 52%/48%, the fee allocation is disproportionately 2%/98% - he asked if this disproportion is justified. He also noted that he is not advocating for all passive managers, but rather, asked for the analysis that advocated for the continued use of active managers.

Ms. Murphy responded that staff has done a lot of work regarding this and in particular, the 10-year outlook as it concerns OCERS' projected returns – this work and presentation is planned for the upcoming Strategic Annual Planning Off-site Meeting. She provided a preview, explaining that in working with Parametric, estimated that pure liquid markets would provide approximately 5%; Meketa's capital markets assumptions, which includes privates, brings OCERS to 6%. In other words, she explained that the illiquidity premium adds approximately 100 bps, on top of the 5% of beta, in sum is well shy of OCERS' targeted return of 7%. Therefore, she explained there is a need for active management to fill the gap between the 6% and 7%.

Mr. Ball clarified his question, asking about OCERS' passive active and illiquid allocations, specifically if illiquids are included in the passive vs. active allocations.

Ms. Murphy responded no, illiquids are not part of the passive vs. active allocation charts.

Ms. Murphy responded that the 100 bps gap that OCERS needs to make up is across all asset classes. She observed that if private equity is only sized at 8%, the Committee cannot expect it to generate 100 bps; she further explained that the portfolio will need to generate alpha across all asset classes to contribute to fill that gap.

Mr. McCourt responded that he has data that might answer some of Mr. Ball's question. He reported that OCERS paid 65 bps on average to the active managers of the liquid portfolio, or \$ 4 B of assets – these managers on average outperformed their benchmark by 2.2% relative; he continued to explain that some of this indicates inherent imperfection of benchmarking. However, he also opined that it is an unrealistic expectation going forward for active managers to continue to outperform because 2017 was a particularly good year.

Mr. Prevatt asked about fees in relation to the returns generated.

Ms. Murphy responded that, for example, private equity outperformed in 2017, explaining that sometimes public equity markets will outpace private equity markets, depending on the liquidity of



the market at that time, but in general would pay more for the asset class that will typically produce more.

Mr. Ball asked Mr. McCourt, in evaluating fees, if it would be better to compare gross returns to fees, rather than worrying about benchmarking.

Mr. McCourt responded no, as OCERS should not pay active managers for returns that are naturally generated through the market. He continued that the Committee will not know the winner between active vs. passive a priori, some years active management will provide excess alpha, some years they will not. He expressed that it is good to track annually, but a clear winner will not really be known for 10 years.

Ms. Murphy added that as part of staff's Fee Report, she and Ms. Chary will present a way on how to think about this debate.

Ms. Chary noted the importance of this initial Fee Philosophy discussion, particularly situations and opportunities when OCERS is a price taker vs. a price setter.

Mr. Ball stated that he is not concerned about performance fees, explaining that if the manager has charged performance fees, then the manager has generated performance gains for OCERS. He also reported he is not concerned about illiquid assets, i.e., private equity, further explaining he is more so concerned about the genesis of other fees.

Ms. Chary described varying approaches to managing investment fees.

Ms. Chary, Ms. Murphy, Mr. Emkin and Mr. Ball particularly discussed fee structures where allocators either pay a 1% management fee or a 30% performance fee (as opposed to more market terms where allocators pay both the management and performance fees).

Ms. Freidenrich and Ms. Chary discussed OCERS' Investment Policy Statement and its stated performance objectives.

Mr. Eley and Ms. Murphy discussed return objectives as it relates to inflation, including the more detailed breakdown provided by OCERS' actuary, Segal Consulting.

Ms. Chary discussed net of fee return goals, by asset class, over 3- and 5- years. She noted that OCERS' private equity fund-of-fund portfolio did meet its return objectives over a 3-year basis, and narrowly missed on a 5-year basis.

Ms. Chary and Ms. Murphy described the costs and benefits of waterfall structures.

Ms. Murphy described OCERS' fee structure with one of its credit managers; she explained the advantages and disadvantages of structuring a preferred return at a very low level.

Mr. Ball opined that there is no right or wrong way, but rather questioned how staff is structuring and negotiating fees.

Ms. Murphy reported that staff continues to work on understanding if the alpha generated by OCERS' investment managers is commensurate with the capital invested with the managers.

Mr. Eley and Ms. Murphy discussed managers whose alpha was negated by fees versus those whose performance was below benchmark.

Ms. Chary and Ms. Murphy presented a slide on the ratio between gross alpha and fees, by asset class. They further defined managers as LP-Friendly, GP-Friendly, or neutral. They reported that this work has only been done over 1 year but the intention is to work on this over multiple years such that staff can analyze trends and outliers.

Ms. Murphy observed that the real concern is a situation where a manager generated alpha, but the manager's fee outweighed the actual net return given to OCERS.

Mr. Ball and Ms. Murphy discussed the hierarchy of fee terms.

Ms. Murphy observed that each asset class has its own unique hierarchy of fee terms.

Ms. Murphy described her experience across various market cycles, and the importance of liquidity, specifically as it relates to market dislocations.

Mr. Delaney, Ms. Freidenrich, and Ms. Murphy further discussed various fee structures, specifically the fee structured discussed earlier regarding a preferred return stuck at a very low level.

Ms. Murphy discussed areas of the market where OCERS can and should capitalize on its size and have improved LP-terms, as well as areas of the market where OCERS is starting to be more progressed and capture not merely lower fees, but also seed economics through "First Mover Advantage."

Mr. Ball continued the discussion the "First Mover Advantage" and observed that at some point Ms. Murphy owes the Committee a presentation on how she is organizing the investment department because that plays into OCERS' ability to actually execute.

Ms. Murphy expressed agreement.

Mr. Ball applauded the Fee presentation, noting that staff is heading in the right direction. He stated that in October, the delegated authority discussion will be a very robust conversation that will get to the point of delegated authority for some assets and an exception process for other assets. He expressed that there is a limited, restrictive process with some flexibility, but needs to be documented in a policy document that can then be referred to so that everyone knows what the Committee agreed upon.

***The Committee recessed at 1:30 p.m.***

***The Committee reconvened at 2:02 p.m.***

#### **I-11 2Q 2018 PORTFOLIO RISK DISCUSSION**

*Presentation by Allan Emkin & Colin Beebe, CFA, PCA*

Mr. Emkin and Mr. Beebe presented PCA's 2<sup>nd</sup> Quarter 2018 Portfolio Risk Discussion for OCERS' portfolio.

Mr. Bebee observed that the initial 5% allocation to the Risk Mitigation Strategies (RMS) portfolio, would not be impactful, while a larger one, with an inclusion of additional strategies over time, would be impactful. He stated that there would be further discussion concerning RMS at the Strategic Annual Planning Offsite Meeting.

Mr. Bebee stated that the RMS portfolio is focused on longer-term risks and drawdowns.

Mr. Bebee reported that PCA has been really focused on the interplay between monetary and fiscal policy, specifically as it relates to inflation and economic growth.

Mr. Emkin discussed OCERS' enviable position of being cashflow positive – he observed that OCERS, can capitalize on other people's distressed situations. He expressed his opinion that such situations are the only real ways to add alpha, or value over the long-term relative to what the markets naturally provide.

Mr. Emkin observed that the global market dynamics are as strange as they have ever been; in particular, he referenced the global trade wars and tariffs between the U.S. and China. Given all the uncertainty, he stated that the role of RMS and diversification is as important as they have ever been.

Mr. Ball asked for a preview of PCA's presentation at the upcoming Strategic Annual Planning Offsite Meeting.

Mr. Emkin responded that PCA will discuss (1) the size of the RMS portfolio needs to be meaningful; and (2) other strategies that should be considered, i.e., strategies that are better diversifiers than the incumbent strategies.

Ms. Murphy further described that there would be a deeper dive into RMS at the November and December Investment Committee Meetings, with a goal of recommended action items by the December Meeting, if not sooner.

#### **I-7 PRIVATE CREDIT REVIEW**

*Presentation by Molly A. Murphy, CFA, CIO, OCERS; Stephen McCourt, CFA, Meketa; & Laura Wirick, CFA, CAIA, Meketa*

Mr. Ball briefly described his concern about the Asian market environment and asked about OCERS' private credit exposure in Asia.

Ms. Murphy responded that staff and consultants had re-categorized OCERS' Asian private lending manager, OCP, private equity, given its higher risk, higher return, and less liquid profile.

Mr. Ball further explained that he is more concerned with the legal structure in Asia.

Mr. Atkinson responded that OCP has structured deals that are more ring fenced under English law; for example, he explained that even though OCP may have struck a Chinese deal, OCP has structured it to be bound by English law.

Mr. Prevatt asked staff to update the Investment Manager Monitoring Subcommittee binder in BoardVantage.

Mr. McCourt discussed the ongoing structure of OCERS private credit investments and provided information upcoming staff and Meketa recommendations as it relates to private credit, including geographic diversification targets/ranges, leverage levels, as well as current re-up opportunities as well as a new First Mover Advantage opportunity.

**I-10 2Q 2018 PORTFOLIO EVALUATION REPORT**

*Presentation by Stephen McCourt, CFA & Laura Wirick, CFA, CAIA, Meketa*

Mr. McCourt and Ms. Wirick presented Meketa's 2<sup>nd</sup> Quarter 2018 Portfolio Evaluation Report for OCERS' portfolio.

Mr. McCourt first reported that Ms. Heiserman will be leaving Meketa for a Seattle-based technology company.

Mr. McCourt focused his presentation on broad themes over the last year ending June 30, observing that some of the data points raised in a quarterly report are just noise. He noted that OCERS' return was solid, on top of peer group averages and the policy index. Whereas 2017 was boosted by a recovery in emerging market equities and international equities as a whole, 2018 has been marked by a sharp reversal by those asset classes. 2018 thus far has also seen material outperformance of U.S. equities relative to the rest of the world. He reported that OCERS, relative to peers, is more overweight emerging market equities, and underweight U.S. equities.

Mr. McCourt noted that despite the market narrative that active managers are struggling relative to passive, OCERS' active managers, over the last 12 months, experienced the converse.

Mr. McCourt observed that both staff and Meketa acknowledge that fine-tuning the real assets portfolio needs to be done – he reported that, relative to peers, this area of the portfolio, specifically energy funds, has caused more portfolio degradation.

Mr. McCourt observed that the 10-year performance data includes the Lehman Brothers crash, so going forward, should there not be another similar drawdown, those numbers will roll off, and thus OCERS' nominal performance numbers will look better.

Ms. Wirick reported that the real assets allocation is slightly below the policy range, while the equity allocation is near the top of its policy range. She noted that these two asset classes will particularly be discussed at the upcoming Strategic Annual Planning Offsite Meeting.

Mr. Ball asked, regarding emerging markets equities, if Meketa can separate foreign exchange movements from the underlying equity.

Mr. Ball asked if the Committee should be looking at emerging markets equities differently given a significant portion of those returns are derived from the respective currencies' movements.

Mr. McCourt responded that Meketa will come back with precise data; for now, he observed the high correlation between currency and stock price action, positing an estimate that over the last 7 years, 1/3 of OCERS' emerging market equities losses are due to currency depreciation and 2/3 stock in terms of local currency terms. He also reported that returns of both managers and benchmarks are denominated in USD, so they are equally affected by currency changes. He also noted that at the asset class level, it is worth noting that emerging market equities are not only volatile, but also the currencies are volatile.

Mr. Ball expressing his hometown bias, observed that the portfolio appears to be relatively more concentrated in ex-U.S.

Mr. McCourt responded that it would be a good educational topic for a longer presentation. He observed that OCERS' portfolio and most portfolios take a neutral global weight across U.S.,

international developed, and emerging market countries. Based on the market capitalization weight of each country, he observed that roughly translates into a 50% U.S./50% non-U.S. He noted that while historically pension portfolios were more geared towards the U.S.; that bias has gone away, due to: (1) Good theoretical evidence that suggests the most efficient global portfolio matches the global market capitalization weight of the global capital markets; (2) Global active managers arguably are better able to find more value and more opportunities if they are not handicapped to solely the U.S. That said, the last 10 years, pension portfolios would have been better off staying home invested in U.S. equities. Today, armed with all the best available information, specifically valuation information where some suggest the U.S. market is two times overvalued relative to ex-U.S. markets, he stated that the difficulty is believing the U.S. will outperform – he observed, the U.S. may outperform, but a lot of bad things need to happen to ex-U.S. markets and a lot of good things need to happen to the U.S. in order for the U.S. to outperform from today's valuations.

Mr. Lindholm, Ms. Wirick, and Ms. Murphy discussed managers on Watch List, particularly the emerging market debt managers.

Ms. Wirick also noted that staff and Meketa have been working and evaluating this space, particularly on what the appropriate mix of sovereign debt and corporate debt, and also local currency debt relative to USD.

Ms. Murphy reported that staff had put those respective managers on Watch List earlier in the year; she described the several touch points that staff has done with the managers to ensure proper vetting.

Mr. Lindholm stated his deep appreciation for the information provided within the quarterly portfolio evaluation report.

Mr. McCourt also emphasized the need for the Committee to understand the importance of benchmarks and how it plays a role in portfolio and manager evaluation.

## **I-8 MANAGER SELECTIONS & TERMINATIONS REPORT**

*Presentation by Molly A. Murphy, CFA, CIO, OCERS*

Ms. Murphy provided background information concerning the updated and improved Manager Selections & Terminations Report, formally called the Manager Activity Report. She observed that there were three key takeaways aimed at addressing the Committee's concerns regarding staff's original Manager Activity Report from the prior month's Investment Committee Meeting: (1) standardized format with pronounced pertinent details, alleviating the Committee's need to search through a memo format to find such information; (2) more information regarding fees and performance data; and (3) color and context that informed the Committee of where the managers would reside in the portfolio.

Mr. Lindholm suggested that OCERS' Watch List information be outlined in this report.

Ms. Murphy responded that both manager terminations and Watch List are outlined in agenda item I-9 Report – Portfolio Activity & Compliance.

Ms. Murphy described the structure of the Manager Selections & Terminations Report. She particularly discussed the Report's Investment Policy Compliance. She informed the Committee that this section addresses and confirms whether the investment is within the Committee-approved (1)

asset class structure, i.e., exposure as it relates to strategy, sub-strategy, and geography; (2) risk constraints, i.e., commitment size as it concerns the Committee's budget limitations; and (3) role, i.e., expected role within the context of the portfolio. She presented the Report's Investment Thesis section, which addresses the manager's risk-return profile and their unique opportunity set. She described the Report's Due Diligence Process section, which speaks to the due diligence done internally (staff, legal) and externally (consultants, legal). Finally, she discussed the Report's Fees and Expenses section, which attempts to define market reasonable terms and whether the manager's fee structure is in or out of synch with market standards.

Ms. Murphy summarized that the new report is an effort to get to the pertinent information in a streamlined way.

Mr. Delaney summarized that this updated Manager Selections & Terminations Report is staff's response to the Committee's expressed concerns from the prior Investment Committee Meeting. He noted that the staff is seeking comments and suggestions from the Committee, particularly if the new report is directionally correct as it relates to the Committee's concerns.

Ms. Murphy presented GGV, a premier venture capital fund focused on internet strategies; she described GGV within the framework of the Manager Selections & Terminations Report.

Ms. Murphy also discussed GGV Plus and the rationale for this vehicle attached to GGV; she explained how GGV plus enables a more efficient use of OCERS' capital, particularly as it relates to GGV's winners.

Mr. Ball suggested that the Report could include a section that addresses co-investment and follow on opportunities.

Mr. Ball expressed his preference for the fees section to be a matrix of all the possible fee options. Further, rather than the Report stating "market reasonable," he expressed his preference that the report exactly state what the fees are.

Ms. Murphy addressed Mr. Ball's concerns, stating that OCERS' confidentiality agreements and NDAs, particularly with private equity managers, would prohibit the report from presenting fee structure specifics.

Mr. Ball challenged and suggested that staff needs to think of a way to address this issue, i.e., defining market reasonable fees, as well as if the fees are above or below market reasonable, in a more descriptive way than currently presented in the Report.

Ms. Murphy explained that the Report would define ranges for market reasonable fees for each investment manager within the context of its asset class and strategy. Specifically, for example, she stated that each Report's Fees and Expenses section would have unique market reasonable ranges for real estate, private equity, etc.

Mr. Ball asked how this definition and range of market reasonable does not violate confidentiality agreements with the manager.

Ms. Murphy responded that the range is wide enough to alleviate GGV's confidentiality concerns.

Mr. Ball asked about preferred returns.

Ms. Murphy responded that GGV, in this instance, does not have a preferred return structure.

Ms. Murphy also explained that, particularly as it relates to the Fees and Expenses section, staff would ask each and every manager what fee and expense information staff can share in the Report.

Mr. Ball asked about how and when does staff know when to come back to the Committee prior to an investment commitment because fees and expenses are not market reasonable.

Ms. Murphy responded that during closed sessions the Committee would be able to address specific details.

Mr. Ball, Ms. Murphy, and Mr. Delaney discussed fee exception situations, i.e., a preferred return was absent, or fees are not market reasonable, and the process that would require staff to get pre-approval prior to any commitment. They agreed that this would conversation would be further discussed at the October Investment Committee Meeting.

Mr. Prevatt noted that some strategies, particularly private equity deals, require quick turnaround times between due diligence and approved commitments.

Mr. Ball, Mr. Prevatt, Mr. Lindholm, and Ms. Murphy expressed agreement that this issue would be further discussed at the October Investment Committee Meeting.

Ms. Murphy also reported that staff will work with OCERS' consultants on defining normal industry standards and exceptions in order to help define OCERS' wanted parameters.

Ms. Freidenrich expressed concerns with the updated Manager Selections & Terminations Report; her concerns included an upfront section describing the difference between GGV and GGV Plus.

Ms. Murphy explained that staff's updated Report tried to not be redundant, i.e., staff did not want to repeat information that TorreyCove already reported in their report.

Ms. Freidenrich expressed her preference that the TorreyCove report and staff's report be independent and standalone.

Ms. Freidenrich also expressed her concerns regarding market reasonable terms, specifically wanting more precision in the definition.

Ms. Freidenrich expressed other concerns, including GGV's management team average tenure was only eight years. She also expressed her preference for "GP-friendly" section to be renamed "LP-unfriendly."

Mr. Prevatt addressed Ms. Freidenrich's concerns, asking Ms. Freidenrich if it would be helpful for her to have access to more detailed staff and consultant due diligence reports.

Ms. Freidenrich responded that her preferences is for one report, with all the upfront basic information, rather than having to wade through multiple different reports.

Mr. Prevatt noted that access to such due diligence reports is available for access for Trustees upon request.

**I-9 REPORT - PORTFOLIO ACTIVITY & COMPLIANCE**

Written report only

Ms. Murphy explained that historically this agenda item was a verbal presentation; however, she stated during several prior Investment Committee Meetings, this agenda item was taken in only as a written report.

**I-1 QUIET PERIOD - INVESTMENT RELATED SEARCHES**

Written report only

Ms. Murphy noted that staff is in legal negotiations regarding contract renewal with OCERS' incumbent proxy services provider, ISS. Later in the fall, she also stated that staff will provide a proxy services presentation as an update to the Committee.

**\*\*\*\*\*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.

**COMMITTEE MEMBER/CEO/CIO/STAFF/CONSULTANT COMMENTS**

Mr. McCourt noted that we are in the longest bull market post the Great Depression. He expressed his fear that the longer the market is without a 10% correction, the more likely the market will have a 20-30% correction.

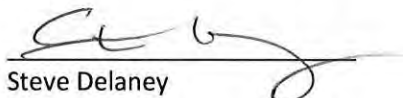
Mr. Delaney, in order to address the Committee's delegated authority concerns that Ms. Murphy is currently serving under, he will hand out OCERS' current CIO Charter and Investment Policy Statement to each Trustee after the meeting.

**COUNSEL COMMENTS**

None

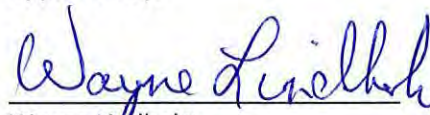
**ADJOURNMENT:** The Chair adjourned the meeting at 3:40 p.m.

Submitted by:



Steve Delaney  
Secretary to the Committee

Approved by:



Wayne Lindholm  
Chair