

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

**INVESTMENT COMMITTEE MEETING  
October 25, 2018**

**MINUTES**

Attendance was as follows:

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

Also Present: Steve Delaney, Chief Executive Officer; Molly Murphy, CFA, Chief 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

Meketa Investment Group: Stephen McCourt, CFA; and Laura Wirick, CFA, CAIA  
PCA: Allan Emkin  
TorreyCove: Nic DiLoretta; David Fann; and Heidi Poon, CFA, CAIA  
Townsend Group: Jennifer Young Stevens; and Felix Fels

The Chair called the meeting to order at 9:01 a.m. Mr. Eley 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.

**C-1 COMMITTEE MEETING:**

**Approval of Meeting and Minutes**

Investment Committee Meeting	July 26, 2018
Investment Committee Meeting	August 30, 2018
Investment Manager Monitoring Subcommittee Meeting	September 6, 2018

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

**CIO COMMENTS**

**I-4 CHINA A-SHARES DISCUSSION**

*Presentation by Vivian Lin Thurston, CFA & Stephen Weeks, William Blair*

Ms. Murphy introduced William Blair's Vivian Lin Thurston, CFA and Stephen Weeks.

***Ms. Freidenrich arrived at 9:12 a.m.***

Ms. Thurston and Mr. Weeks presented William Blair's perspective on the opportunities associated with the opening of the China A-Shares market earlier in the year.

***Mr. Prevatt arrived at 9:19 a.m.***

The Committee asked Ms. Thurston for her views on liquidity, valuation, regulatory, and geopolitical risks associated with foreign capital allocated to the Chinese markets.

Ms. Murphy reported that although OCERS is familiar with William Blair and comfortable with their due diligence process, further work is required prior to potentially allocating to this space. She described that 2018 was an educational year, recalling that staff brought BlackRock to present to the Committee on the China A-Share market earlier in the year. She observed that there is a finite number of Chinese A-Share funds; and those that exist, have short performance track records. Further, she explained that most funds in this space have limited scalability, and therefore OCERS would likely be capacity constrained.

***The Committee recessed at 10:20 a.m.***

***The Committee reconvened at 10:32 a.m.***

**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**

**A-2 PRIVATE REAL ASSETS PACING**

*Presentation by David Fann, & Nic DiLoretta, TorreyCove*

Ms. Murphy briefly provided background and timeline commentary for the pacing discussion: she noted that the private real assets discussion is the last pacing plan review, as staff and consultants reviewed private equity, real estate, and private credit earlier in 2018.

Mr. DiLoretta presented TorreyCove's Private Real Assets Pacing Program Plan. He explained that while he is presenting two base level 2019 commitments to reflect the possibility of a slight modification to OCERS' asset allocation, i.e., the current 9% target allocation vs. the recommended 8% target, the projected increase in commitment pacing at 5% is similar.

Mr. Fann explained the investment rationale for a real assets allocation, noting their diversification benefits and lower correlation profile to equities and fixed income.

Ms. Freidenrich expressed concerns about the recommended commitment size ranges; she observed that the wide range could lead to a large number of small commitment sizes, and thus would weaken OCERS' efforts at concentrating OCERS' portfolio and limiting the number of investment managers.

Ms. Murphy responded that the sub-strategies within real assets have a range of capacity constraints – those sub-strategies at the lower end would limit the size of OCERS commitments. That in mind, she further explained that OCERS would be size-appropriate when OCERS can in an ongoing effort to keep manager name proliferation down as much as possible.

Ms. Murphy discussed the blurred lines that exist between energy and infrastructure strategy classifications. For example, she described pipelines as an investment that sits across the continuum of energy and infrastructure; whereas pipelines closer to the end-user, i.e., the consumer or utilities, are more appropriately classified as infrastructure, those pipelines closer to the commodity are more suitably classified as energy.

Mr. Fann also noted that while it is staff's and TorreyCove's intention to have pure strategy classifications, due to an evolving market, managers' strategies may occasionally not fit purely in one asset/sub-asset, and thus may cross over into other parts of the OCERS portfolio.

Ms. Murphy further observed these were the reasons why staff and TorreyCove preferred to look at the portfolio holistically, rather than to break up the pacing plan by sub-categories of energy and infrastructure.

Ms. Murphy, Mr. Dewane, and Mr. Lindholm discussed staff's and TorreyCove's recommendation.

Ms. Murphy recommended that the Committee approve both the 8% and 9% targets, contingent upon the outcome and approval from the item A-4 Asset Allocation to be discussed later in the day's meeting.

A **motion** was made by Mr. Dewane and **seconded** by Mr. Ball to approve both the 8% and 9% pacing plan targets for the 2019 private real assets commitments and the sub-sector ranges, pursuant to the Asset Allocation discussion. The **motion carried unanimously.**

### **A-3 CORE OPEN-END REAL ESTATE REBALANCING**

*Presentation by Jennifer Young Stevens & Felix Fels, Townsend*

Ms. Murphy provided brief background commentary on OCERS' current underweight and overweight positioning in the OCERS real estate portfolio.

Ms. Stevens described that this real estate rebalancing effort aims to optimize weightings within the core portfolio, by providing diversification benefits, lowering fees, and improving the expected risk-adjusted net returns.

Ms. Murphy, Mr. Lindholm, and Ms. Stevens discussed OCERS' real estate managers on Watch List, future near-term decision points, and the costs and benefits of maintaining the current Watch List.

Ms. Stevens and Ms. Murphy explained the investment rationale for two potential investments.

Mr. Ball, Ms. Stevens, and Ms. Murphy further discussed Townsend's ability to secure LP-friendly fee structures.

Ms. Freidenrich asked about the delegated authority process and if this potential investment, since it would be a shift in sector exposures, required coming back to the Committee for approval.

Ms. Murphy responded that this would not require coming back to the Committee. She explained the shift in sector exposures would be part of approving the rebalancing and manager selection would be led by staff and Townsend.

Ms. Freidenrich expressed concern with commitment sizing.

Ms. Stevens and Ms. Murphy further described that certain strategies and situations are capacity constrained – that said, they explained that OCERS would invest with larger size commitments where both appropriate and possible.

A **motion** was made by Mr. Ball and **seconded** by Mr. Baldwin to approve the rebalancing of \$150 million from a generalist U.S. core open-end real estate manager to two specialist (U.S. core diversified niche property and U.S. core industrial) managers.

Ms. Murphy suggested the addition of the word “approximately” to the recommendation to \$150 million.

The Committee in unison agreed with the suggestion, and modified the original motion.

A **motion** was made by Mr. Ball and **seconded** by Mr. Baldwin to approve the rebalancing of approximately \$150 million from a generalist U.S. core open-end real estate manager to two specialist (U.S. core diversified niche property and U.S. core industrial) managers. The **motion carried unanimously.**

#### **A-4 ASSET ALLOCATION**

*Presentation by Molly A. Murphy, CFA, CIO, OCERS & Stephen McCourt, CFA, Meketa*

Ms. Murphy explained that staff’s and Meketa’s asset allocation recommendations are intended to optimize the portfolio and solve a few outstanding issues. She noted that the recommendations would:

1. Use the portfolio’s risk budget more efficiently;
2. Participate as much possible in the upside, with less drawdown risk;
3. Maintain a reasonable expectation of achieving OCERS’ actuarial return over the long-term;
4. Increase the Risk Mitigation Strategies (RMS) allocation to better limit downside risk, with the least adverse impact or least amount of frictional costs to the current portfolio, i.e., transaction costs.

Ms. Murphy and Mr. McCourt particularly discussed the real assets portfolio and its current allocation. They explained that since the allocation is already at the proposed target allocation, the recommendations would prevent transactional costs from detracting from returns.

Mr. McCourt further explained that staff’s and Meketa’s recommendations are tweaks to the current asset allocation policy and thus would not substitute the typical OCERS’ asset allocation review cycle.

Mr. McCourt described that these tweaks effectively barbell the risk in the OCERS portfolio; he concluded that the consequent portfolio would be slightly more defensive, and yet would not diminish expected long-term returns.

Mr. McCourt provided the rationale for adding in a unique strategies allocation to the OCERS asset allocation mix; he explained that as markets evolve, new opportunities arise, and therefore, this allocation would already be in place to address this opportunity set.

A **motion** was made by Mr. Packard and **seconded** by Mr. Dewane to approve the asset allocation policy changes (with detailed asset and sub-asset class targets and ranges outlined in Meketa's presentation):

1. Increase Risk Mitigating Strategies and Private Equity
2. Decrease Real Assets and Credit
3. Reconsider a Unique Strategies asset class

Mr. Ball expressed concern regarding the unique strategies allocation, particularly within the context of rebalancing.

Ms. Murphy explained that staff could always rebalance, even prior to delegated authority, as long as the assets are still within their Committee-approved ranges.

Mr. Ball clarified his concern, stating that prior to delegated authority, the Committee would have prior knowledge of newer strategies.

Mr. Emkin further explained the rebalancing process; he described that since the Committee has already approved the asset classes, rebalancing is simply a mechanical transfer from strategies at or near the higher end of their approved range.

Mr. Emkin opined that due to the Committee's monitoring and oversight responsibility, if he were on the Committee, he would focus and question staff and consultants why, for example, is the private equity allocation not at the approved target allocation.

Mr. Ball expressed his concern regarding the potential latitude implicit in the recommended ranges. He opined that he is not necessarily against the proposed recommendations; conversely, he expressed his desire that the Committee, staff, and consultants need to make the process explicitly clearer in public documents, i.e., the Investment Policy Statement, and CIO Charter.

Mr. McCourt suggested that the Committee differentiate the discussion of delegated authority from the discussion on ranges. He explained that the ranges are best practices for pension fund portfolio management: the ranges allow the portfolio to move within a band to account for normal market moves. Otherwise, he outlined that staff would be forced to rebalance simply to account for short-term price action, whereby the portfolio would incur unnecessary trading costs. He encouraged the Committee to separate delegated authority from these ranges, because the concept and sizes of these ranges are normal and appropriate for pension fund portfolio management.

Mr. McCourt further stated that the ranges today closely approximate the width of the recommended ranges; he continued to observe that, with the exception of the proposed unique strategies allocation, the recommendations do not expand delegated authority.

Mr. Ball remarked that he is supportive of the ranges. He explained that his issue does not concern the recommended ranges; rather, his issue centers around the lack of clarity about what staff can and cannot do.

Mr. Lindholm asked and urged the Committee to limit the discussion to item A-4, rather than complicate this discussion with item I-5 DELEGATED AUTHORITY – CONTINUED DISCUSSION. He

expressed similar sentiments to Mr. McCourt's recent comments, stating that item A-4 and item I-5 are two separate issues.

Ms. Freidenrich expressed concern with the unique strategies allocation. She explained that OCERS has done a great job in making the portfolio comparable to peers in the pension industry. She opined that a unique strategies allocation would make benchmarking a difficult exercise. She also noted that this recommendation is not minor since it would be adding a new asset class.

Mr. McCourt reported that other pensions have similar allocations and categories, but have usually categorized the unique strategies allocation as "other" – this clearly demarcates what does and does not categorically fit in traditional private and public asset classes and strategies.

Mr. Lindholm asked for other pensions' terminology in categorizing asset classes and strategies that do not typically fall within the standard confinement of traditional public and private markets.

Ms. Murphy responded that other pensions have used terms such as "diversifying strategies" or "opportunistic."

Mr. Lindholm and Mr. McCourt discussed the background, and in particular, the concept, and origin of the unique strategies allocation.

Mr. McCourt explained that Meketa suggested and recommended the allocation; he provided health care royalties as an example that could be categorized as private credit. However, he explained that industry best practices would categorize such royalties as unique strategies; that differentiating process would allow private credit to be clearly defined as strictly private credit.

Ms. Freidenrich explained her concerns because the Committee is already permitting ample latitude through delegated authority.

Mr. Baldwin expressed concern regarding the 5% reduction in the real assets allocation.

Mr. McCourt addressed Mr. Baldwin's concerns, noting the following primary reasons:

1. Real assets has a 22% target and is already significantly below that target. Therefore, maintaining this target would require new investments into that area. In addition, he stated that even the recommended 17% target is already higher than the industry's allocation.
2. The primary reduction in real assets is through the public market strategies allocation. He observed that this allocation can be useful occasionally, and consequently, staff should not be compelled to have to fill that allocation. There should be flexibility to move tactically there when opportunities arise. This situation also applies to legacy allocations to timber and agriculture.

Mr. Baldwin suggested incorporating Environmental, Social, and Governance (ESG) factors as an overlay to the OCERS portfolio.

Mr. Prevatt addressed some of the Committee's concerns. He observed that OCERS' benchmark is not OCERS' peers. He also remarked that the unique strategies allocation provides an opportunity to place strategies that do not precisely fit in other asset classes and strategies – therefore, in an effort to be more transparent, there is no opportunity to hide them in another asset class. He also opined that the recommendations are not a major change since they are only shifting ranges and targets.

Mr. Dewane explained that the Committee has digressed too far into the details and wandered away from being a policy-making Board. He observed that the policy now is same as before, particularly about ranges, targets, and rebalancing – he noted that this discussion requires a policy-driven Board and this discussion is not about delegated authority. He suggested that perhaps a better title for this discussion would be portfolio optimization, rather than asset allocation.

Mr. Dewane also expressed agreement with Mr. McCourt's and Mr. Prevatt's earlier comments regarding unique strategies – specifically, that the addition of a unique strategies allocation would uniquely clarify the categorization of the added investment manager strategy.

Mr. Eley noted that he was in agreement with the recommended barbell approach and the tweaks to the portfolio, expressing that the portfolio is heading in the right direction.

Mr. Eley addressed Ms. Freidenrich's concerns, observing that none of the ranges has really moved.

Mr. Eley addressed Mr. Ball's concerns. He stated that the current Investment Committee Chair and Vice Chair, through ongoing conversations with the CIO, have ensured that the CIO will bring education to the Committee, such that there is discussion, prior to any investment, for situations where a potential investment is significant, new, or nuanced.

Mr. Hilton asked for a realistic timeframe to achieve the recommended changes.

Ms. Murphy responded that each asset classes had unique timelines; for example, she described that it could likely take several years to achieve the targets and ranges for private equity. Conversely, for risk mitigating strategies, she observed that it could take 6-12 months.

A **motion** was made by Mr. Packard and **seconded** by Mr. Dewane to approve the asset allocation policy changes (with detailed asset and sub-asset class targets and ranges outlined in Meketa's presentation):

1. Increase Risk Mitigating Strategies and Private Equity
2. Decrease Real Assets and Credit
3. Reconsider a Unique Strategies asset class

The **motion carried 8-1**, with Ms. Freidenrich voting no.

Ms. Fredenrich expressed her rationale for her opposition, explaining that while she does support the overall asset allocation changes, she expressed concern with the unique strategies addition within the overall context of delegated authority.

***The Committee recessed at 12:27 p.m.***

***Mr. Lindholm left at 12:27 p.m.***

***The Committee reconvened at 1:03 p.m.***

## **INFORMATION ITEMS**

### **I-1 INVESTMENT COMMITTEE COMMUNICATIONS**

Written report only

**I-2 SECURITIES LITIGATION UPDATE**

Written report only

**I-3 REPORT – PORTFOLIO ACTIVITY**

Written report only

**I-5 DELEGATED AUTHORITY – CONTINUED DISCUSSION**

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

Mr. Delaney and Ms. Murphy provided background commentary and a timeline of the delegated authority steps and actions taken thus far in 2018.

Ms. Murphy noted specifically that this discussion is in response to questions and concerns voiced from the August Investment Committee meeting.

Ms. Murphy described the updated Manager Selections & Terminations Report, which now includes a more robust risk profile section as well as an auditor section. She also discussed the placemat, located at the dais for each Trustee that depicts the structure of each of the private markets asset classes. She explained that the placemat provides many details: asset class approval date, pacing plan, ranges, targets, and geography/sector where appropriate.

Mr. Delaney suggested that, in order to pull all the information together from all the delegated steps the Committee, staff and consultants have done, he and Ms. Murphy would work with Ms. Ratto in adding the placemat's information to the Investment Policy Statement's appendix.

Mr. Eley suggested that staff keep the placemat in paper format for a couple more Investment Committee meetings prior to laminating, thus leaving the placemat open for further feedback.

Mr. Ball asked that staff include overweight and underweight percentages for the real estate portfolio.

Ms. Murphy expressed agreement, observing that staff and Townsend could add allocations relative to the NFI-ODCE benchmark, as well as add in the directionality that staff and Townsend are heading in.

Ms. Murphy reported that staff would implement Townsend's information and charts into the placemat as well as in the Investment Policy Statement's appendix.

Ms. Freidenrich expressed thanks for the placemat. She also suggested, for the sake of consistency, the inclusion of pacing charts for each asset class.

Ms. Murphy explained that the placemat allows staff to inform the Committee where the portfolio is and where the portfolio is going.

Mr. Prevatt expressed the need and goal of framing a pipeline discussion for the Committee – this would require education for the Committee, where appropriate; he noted that staff needs to ensure the Committee is informed and aware of potential new deals. He stated that the Almanac presentation at the August Investment Committee meeting required education because it was a differentiated real estate strategy; however, he explained that Almanac did not require an approval vote from the Committee.



Mr. Ball stated that he envisions that the information provided in the placemat, the Manager Selections & Terminations Report, and pricing details and descriptions, specifically from TorreyCove's and Townsend's reporting, are incorporated in the Investment Policy Statement.

Mr. Delaney and Ms. Murphy both agreed that they would work with Ms. Ratto to incorporate and implement into the Investment Policy Statement.

Mr. McCourt introduced Mr. Cass, who manages Meketa's fee models for their private markets coverage.

Mr. Cass discussed various fee structures, the math behind it, the differences in GP and LP preferences, and the rationale driving those respective preferences.

Mr. Emkin observed the importance for the Committee to recognize the management fees automatically given to GPs, how well GP-economics are, even if the GP does not generate returns.

Mr. Eley, Mr. Prevatt, Ms. Murphy, and Mr. McCourt discussed the positive optics for the GP industry and its inclusion of preferred returns, which could give LPs a false sense of comfort.

Ms. Murphy stated that fee negotiations are strategy specific – she explained that OCERS would be a fee setter in some strategies, and a fee taker in others.

Mr. Emkin observed the importance of structuring a preferred return for situations when expectations are not met.

Mr. Dewane noted that the back and forth discussion regarding delegated authority has been an inefficient use of time spent for all parties involved. He rationalized that catering to each Trustee's unique preferences has constrained the Committee from being a policy-driven Board, and could have detracted from performance as well, given the amount of time that staff and consultants have spent in preparing materials for delegated authority over the last six months.

Mr. Eley observed that the goal of today's discussion aimed at addressing the absence of a unanimous Committee decision concerning delegated authority. He also noted that today provided education to the Committee, and for the sake of record keeping, there was in fact, Board deliberation on delegated authority.

Ms. Freidenrich explained that her no vote on delegated authority was a byproduct of her belief that delegated authority lacked a clear process or structure. She opined that this process was structured after it was approved. She stated her preference for further clarification, noting it concerns her responsibility as a Board fiduciary, as well as to ensure that the CIO clearly knows her responsibilities.

Mr. Hilton explained his rationale for his no vote on delegated authority, reporting that it seemed as if the Committee, staff and consultants had skipped steps and jumped into delegated authority; however, he also expressed gratitude that all parties are finally addressing this issue.

Mr. Eley, Mr. McCourt, and Mr. Cass discussed Meketa's fee model and the various time periods used, particularly as it relates to drawdowns, and the various valuations and preferences wanted.

Mr. Emkin and Ms. Murphy discussed the math that some GPs do with financing and leverage as it concerns LP fees on IRR vs. MOIC, and the use of subscription lines to get to the carry faster.

Ms. Murphy discussed the work that staff has done and will continue to do, particularly in private equity. She noted the importance of cycle-tested managers and manager behavior during market downturns. She also remarked upon the importance of the manager's use of subscription lines and leverage, as well as the manager's operational expertise and restructuring ability. She also stated that this due diligence and analysis all leads to how OCERS should manage fee negotiations because there are many moving variables.

Mr. Ball noted that he is happy to leave fee negotiations to staff, while also stating that it is important for the Committee to know staff's fee matrix due to the various tradeoffs.

Mr. Eley and Mr. Ball commended staff and the consultants for their work and memos on this discussion.

**I-6 2<sup>nd</sup> QUARTER 2018 REAL ESTATE PERFORMANCE REPORT**

*Presentation by Jennifer Young Stevens & Felix Fels, Townsend*

Ms. Stevens and Mr. Fels presented the Townsend Group's 2<sup>nd</sup> Quarter 2018 Real Estate Performance Report for OCERS' real estate portfolio.

Mr. Ball and Ms. Stevens discussed managers on Watch List.

Mr. Fels provided return drivers for OCERS' core and non-core real estate managers.

Mr. Eley and Ms. Stevens discussed the industrial space and the rationale for Townsend's recommendation to add to this sector.

Mr. Ball asked if going forward there would be more granularity into sectoral exposures, i.e., student housing.

Ms. Stevens expressed agreement, noting that while the benchmark does not currently break out that level of sectoral exposures, Townsend is working with the benchmark to add that level of granularity.

**I-7 1<sup>st</sup> QUARTER 2018 PRIVATE EQUITY PERFORMANCE REPORT**

*Presentation by David Fann, Heidi Poon, CFA, CAIA, TorreyCove*

Mr. Fann and Ms. Poon presented TorreyCove's 1<sup>st</sup> Quarter 2018 Private Equity Performance Report.

Mr. Ball asked for the portfolio's average holding period and suggested that TorreyCove have this information for their next report.

Ms. Poon agreed, also responding that due to OCERS' legacy fund-of-fund portfolio, average holding periods would likely be around 10-15 years or longer.

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

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

Ms. Murphy discussed staff's Manager Selections & Terminations Reports for recent commitments in the private equity and private credit space.

Ms. Murphy presented each investment's respective bull and bear case. She also explained staff's due diligence process and the rationale for how staff gained comfort with the complementary risk and return benefits each unique investment is expected to contribute to the OCERS portfolio.

Mr. Eley and Ms. Murphy discussed that in certain private market income-based strategies, staff would be inclined to have preferred returns.

**\* \* \* \* \*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/COUNSULTANT/COUNSEL COMMENTS**

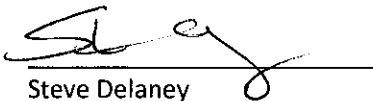
Mr. Eley, Ms. Freidenrich, and Mr. Delaney discussed the August Investment Committee Meeting minutes, staff's placemats, as well as the updated Manager Selections & Terminations Report.

Ms. Murphy observed the importance of talking through the asset allocation, and in particular, the Risk Mitigation Strategies allocation given the downside and upside volatility in the markets.

Mr. McCourt stated for the record, that he liked the placemats and its naming convention.

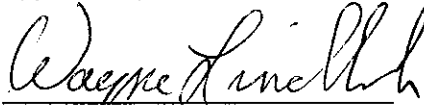
**ADJOURNMENT:** The Chair adjourned the meeting at 2:59 p.m.

Submitted by:



Steve Delaney  
Secretary to the Committee

Approved by:



Wayne Lindholm  
Chair