

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

INVESTMENT COMMITTEE MEETING

March 28, 2019

9:00 a.m.

MINUTES

Attendance was as follows:

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

Absent: Shawn Dewane, Vice Chair; and Russell Baldwin

Also Present: Brenda Shott, Assistant Chief Executive Officer; Molly Murphy, CFA, Chief Investment Officer; Reginald Tucker, Managing Director; David Beeson, Senior Investment Officer; Tarek Turaigi, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Julius Cuaresma, Investment Analyst; Joseph Fletcher, Staff Attorney; Javier Lara, Visual Technician; and Brittany Cleberg, Recording Secretary

Meketa Investment Group: Stephen McCourt, CFA; Laura Wirick, CAIA, CFA; Colin Bebee, CFA

TorreyCove: David Fann; Heidi Poon, CFA, CAIA; Nic DiLoretta

The Chair called the meeting to order at 9:08 a.m. Mr. Vallone 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. Prevatt and **seconded** by Mr. Packard to approve the Consent Agenda. The **motion carried unanimously.**

C-1 COMMITTEE MEETING:

Approval of Meeting and Minutes

Investment Committee Meeting

February 27, 2019

Recommendation: Authorize meeting and approve minutes.

CIO COMMENTS

Ms. Murphy addressed recent Committee questions about the direct private equity program, particularly whether the Investments team has sufficient bandwidth and resources to meet the

growing program's demands. She provided an overview of the Investments team structure. After discussions with Mr. Delaney and Ms. Ratto, she reported that each member of the Investments team would continue to report to Ms. Murphy. She remarked upon her restructuring efforts, including the recent hiring of a Managing Director and the near term new hire for an Investment Analyst. She also described how her modified generalist approach with primary and secondary asset class coverage lends itself to improved risk management, overall skills development, as well as talent retention.

Ms. Murphy observed that many active managers in the U.S. small cap equity value space have outpaced their benchmark. Since OCERS only has a passive equity allocation in this space, she reported that staff and Meketa have recently undertaken due diligence, met with several managers and continue to filter the robust small cap value manager opportunity set without an RFP.

Ms. Freidenrich and Ms. Murphy discussed OCERS' use of RFPs, particularly as it concerns OCERS' historical manager selection and due diligence process versus the current Delegated Authority process.

Ms. Murphy reported that there is no policy that requires the use of RFPs for investment manager selection.

Ms. Murphy and Mr. McCourt discussed the advantages and disadvantages of using the RFP process for investment manager selection.

Mr. Eley discussed the risk of selection bias, observing how new and emerging managers can often be absent from the investable manager universe when the RFP process is not used.

Ms. Wirick further discussed how Meketa strives to encapsulate emerging managers into their entire investable manager universe. She explained that Meketa does not restrict their universe with minimum asset levels or minimum number of years of performance data.

Mr. Delaney observed the significant amount of Committee discussion time spent on this non-agendized item; he asked for Mr. Fletcher's thoughts.

Mr. Fletcher responded, noting the Committee's need to agendize this RFP discussion.

Ms. Murphy reported that staff would bring back an RFP discussion as an agenda item for the April 2019 Investment Committee meeting.

Ms. Murphy provided commentary on the financial markets and the global economy. She remarked upon the robust quarter-to-date performance produced in the equity markets. She also described recent bond market developments, observing that various parts of the yield curve are portending mixed signals as to the direction of the economy.

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.

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

INFORMATION ITEMS

I-1 REPORTS – PORTFOLIO ACTIVITY

Written report only

I-2 MANAGER SELECTIONS & TERMINATIONS REPORT

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

Ms. Murphy discussed recent manager selections and one termination and described the rationale for those respective selections for the OCERS portfolio.

Ms. Freidenrich and Ms. Murphy discussed how the changes in federal tax law has affected the OCERS portfolio.

I-3 3rd QUARTER 2018 REAL ASSETS PERFORMANCE UPDATE

Presentation by David Beeson, SIO, OCERS; David Fann & Nic DiLoretta, TorreyCove

Mr. Beeson provided introductory comments regarding OCERS' real assets portfolio. He discussed recent price action in the commodity complex. He also reported upon positive developments stemming from the OCERS timber portfolio.

Mr. Fann and Mr. DiLoretta presented TorreyCove's 3rd Quarter 2018 Real Assets Performance Report.

Ms. Freidenrich, Ms. Murphy, and Mr. DiLoretta discussed BlackRock's acquisition of Tennenbaum.

Mr. Ball and Ms. Murphy continued the acquisition discussion, and in particular reviewed OCERS' contract rights as a Limited Partner.

Ms. Murphy observed that OCERS' control rights and provisions varies in different asset classes.

Mr. Delaney reported that staff would come back with more detail and color regarding OCERS' contract rights, specifically as it relates to investment manager acquisitions.

Mr. Ball and Mr. DiLoretta discussed recent developments in the MLP market.

Mr. Fann commented upon the Committee's earlier concerns surrounding acquisitions of investment managers. He described the role of the Committee on Foreign Investment in the United States (CFIUS) and recent acquisition activity in the private markets space.

Mr. Packard and Mr. DiLoretta evaluated TorreyCove's and staff's focus on key characteristics in the infrastructure space, particularly income-oriented managers with both inflation protection and growth participation.

Mr. Ball, Ms. Murphy, and Mr. DiLoretta continued this discussion, particularly noting the importance of categorizing managers based on risk and return characteristics, rather than the manager's own naming convention.

Ms. Murphy reported that OCERS' allocations to the infrastructure space was perhaps an unintended byproduct of the 2016 Alternative Income RFP.

I-4 3rd QUARTER 2018 PRIVATE EQUITY PERFORMANCE UPDATE

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

Mr. Fann and Ms. Poon presented TorreyCove's 3rd Quarter 2018 Private Equity Performance Report.

Ms. Poon noted the relatively strong performance of the private equity portfolio, while also reporting upon the performance drag incurred due to the legacy fund-of-fund private equity allocations.

Ms. Poon also provided an update of the portfolio's quarterly cash flows.

The Committee recessed at 10:19 a.m.

The Committee reconvened at 10:40 a.m.

A-2 PRIVATE EQUITY– ASSET CLASS REVIEW

Presentation by Molly A. Murphy, CFA, CIO & Stina Walander-Sarkin, IA, OCERS; David Fann & Heidi Poon, CFA, CAIA, TorreyCove

Ms. Walander-Sarkin presented staff's asset class review of the OCERS private equity program. She provided background comments on OCERS' private equity allocation. She discussed staff's private equity strategy and objectives – she particularly noted that the fee savings from the change from a fund-of-fund private equity program to a direct program, and a diversified portfolio of top quartile managers were two primary objectives.

Ms. Walander-Sarkin and Ms. Murphy reported upon the increased level of manager due diligence required through the change from a fund-of-fund private equity program to a direct program.

Mr. Ball, Ms. Murphy, Ms. Walander-Sarkin, and Mr. Fann further discussed the fees saved from the change from a fund-of-fund private equity program to a direct program.

Ms. Poon presented TorreyCove's asset class review of OCERS' private equity portfolio.

Ms. Poon reviewed staff's and TorreyCove's completed tasks since OCERS' hiring of TorreyCove in April 2018. She also presented forward-looking commentary and guidance on OCERS' private equity pacing plan.

Ms. Freidenrich and Ms. Poon evaluated OCERS' commitments to managers with strong track records. They also discussed how TorreyCove and staff have gained comfort in specific situations where explicit track records may understate actual performance, i.e., new GP launches and conservative valuation practices.

Mr. Hilton observed that the OCERS program did not reach the 2018 target commitments of \$300 - \$350M. Given the recommendation to increase the 2019 target to 10%, he asked how the program could actually achieve the higher annual commitment range of \$400 - \$450M.

Ms. Poon responded, noting that the program is ahead of schedule with the 2019 commitments due to the plethora of high quality GPs in the market.

Mr. Lindholm, Mr. Fann, and Ms. Poon discussed the rationale for staff's and TorreyCove's increase in the allocation to Europe from 12% to its target of 20%. They discussed the relative inefficiency and cheapness in Europe versus the United States, as well as the opportunities that have arose from Brexit.

Mr. Fann provided commentary on the private markets, particularly the robust fundraising environment.

Ms. Freidenrich and Mr. Fann discussed late cycle dynamics, including a brief review of unsuccessful private equity transactions saddled with significant leverage.

Mr. Fann further described how leverage has not been a major driver in the outperformance of private equity. He also noted that staff and TorreyCove continue to prioritize managers that improve companies operationally, rather than financially engineer returns performance with leverage. He described how one of OCERS' private equity managers utilizes a proprietary detailed playbook that outlines specific steps in improving target companies.

A **motion** was made by Mr. Eley and **seconded** by Mr. Ball to approve the pacing plan of \$400-\$450 million in private equity commitments in 2019 to maintain the 10% target. The **motion carried unanimously**.

I-5 REVIEW OF CUSTODY RELATIONSHIP

Presentation by Molly A. Murphy, CFA, CIO & Julius Cuaresma, IA, OCERS

Ms. Murphy provided introductory comments pertaining to her Investment Committee work plan; she reported that staff would have regular annual reviews for complementary service providers to the investment process, including this review of OCERS' custody relationship with State Street. She also indicated that later this year, staff would also review the cash overlay program and the proxy services process.

Mr. Cuaresma described the 20+-year relationship with State Street, including a discussion of current issues and recent collaborative efforts between State Street and OCERS' finance and investments team in resolving those issues.

Mr. Delaney and Ms. Murphy observed that timeliness issues and errors of materiality are not specifically unique to State Street, but rather, endemic to the entire custody services marketplace.

Ms. Murphy commented that while OCERS may have intermittent issues with State Street, other pensions encounter similar issues with either State Street or State Street's competitors.

Mr. Eley and Ms. Murphy briefly discussed the limited custody bank competitor landscape.

A-3 MEKETA/PCA CONTRACT

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

Ms. Murphy provided background commentary about the merger between Meketa Investment Group (Meketa) and Pension Consulting Alliance (PCA). As part of the legal process of the merger, she reported that Meketa and PCA asked OCERS to assign the existing PCA contract to Meketa. This assignment would fall under the combined entity, Meketa Investment Group and would blend the scope of services under the PCA/OCERS contract into the current Meketa/OCERS contract. Further, this assignment would continue with the combined fee terms set under both original contracts. She also observed that both Meketa and PCA are Named Service Providers, and per policy, the Investment Committee must determine whether to assign/change/terminate any contracts due to the merger between Meketa and PCA.

Mr. McCourt provided an update on the merger.

Ms. Murphy presented the Meketa's and PCA's Scope of Review. She described Meketa's and PCA's respective scope of services while asking the Committee to be mindful of the scope of services required by the Committee, the level of independent consultant oversight sought by the Committee, and the risk management services needed by OCERS.

Ms. Murphy and the Committee reviewed the costs and benefits of each of the following actions: (1) Approving the assignment of the existing PCA contract; (2) Terminating the existing PCA contract; (3) Approving a search for a replacement consultant in the role previously filled by PCA; (4) Approving another option as defined by the Committee

Mr. Packard discussed the merits of not assigning the existing PCA contract to Meketa.

Ms. Freidenrich and Ms. Murphy discussed the Risk Mitigation Strategies work done by Meketa and PCA.

Mr. Eley commented upon the advantages and disadvantages of having a Risk Consultant in addition to a General consultant; he particularly noted the benefits of a Risk Consultant given the late cycle dynamics that characterize the current investment environment.

Mr. Prevatt observed that Ms. Murphy was not OCERS' CIO during the time of the Committee's hiring of Meketa as General Consultant and PCA as a Risk consultant, and so he provided a brief background commentary of the hiring process. He specifically commented upon the rationale for seeking the services of PCA's Allan Emkin, who would fulfill the Committee's desire for a secondary voice and balanced opinion outside of the General Consultant. He further discussed the merits of not assigning the existing PCA contract to Meketa.

Mr. Hilton and Ms. Murphy discussed the asset allocation process and compared the involvement of Meketa relative to PCA in driving that process.

A **motion** was made by Mr. Lindholm and **seconded** by Mr. Packard to terminate the existing PCA contract and require Mr. Emkin's attendance.

Ms. Freidenrich expressed agreement with not assigning the existing PCA contract to Meketa. She also believed in the merits of phasing down the relationship given the increase in the RMS portfolio from 5% to 10%. She suggested an amendment to the motion to include a 1-year phase out period for the PCA relationship whereby PCA would continue to provide their quarterly risk report.

Ms. Murphy incorporated Ms. Freidenrich's suggestions into the original motion by adding the following: staff would negotiate for the continued presence of Mr. Emkin and for the continued

delivery of PCA's quarterly risk report for the remainder of 2019. She noted that staff would provide the costs associated with those two respective negotiated requests to the Committee at the April Investment Committee meeting.

Mr. Lindholm expressed agreement with Ms. Murphy's and Ms. Freidenrich's suggested amendments to the original motion.

Ms. Freidenrich withdrew her amendment to the motion.

Upon further discussion, the Committee voted on the motion made by Mr. Lindholm and seconded by Mr. Packard to terminate the existing PCA contract, for staff to negotiate for the continued presence of Mr. Emkin and for the continued delivery of PCA's quarterly risk report for the remainder of 2019, and for staff to bring back the costs associated with those two respective negotiated requests to the Committee at the April Investment Committee meeting. The motion carried 7-1 with voting as follows:

AYES

Mr. Vallone
Mr. Packard
Mr. Lindholm
Ms. Freidenrich
Mr. Prevatt
Mr. Ball
Chair Hilton

NAYS

Mr. Eley

ABSTAIN

ABSENT

Mr. Baldwin
Mr. Dewane

COMMITTEE MEMBER/CEO/CIO/CONSULTANT/COUNSEL COMMENTS

None

ADJOURNMENT: The Chair adjourned the meeting at 12:21 p.m.

Submitted by:


Steve Delaney
Secretary to the Committee

Approved by:


Roger Hilton
Chair