

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

**INVESTMENT MANAGER MONITORING
SUBCOMMITTEE MEETING**

**March 28, 2019
9:00 A.M.**

MINUTES

The Chair called the meeting to order at 9:06 a.m. and read the opening statement into the record. Attendance was as follows:

Present: David Ball, Chair; Frank Eley

Absent: Russell Baldwin, Vice Chair; Shawn Dewane

Also present: Steve Delaney, Chief Executive Officer; Molly Murphy, CFA, CIO; Reginald Tucker, Managing Director, Shanta Chary, Director of Investment; David Beeson, Senior 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

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. Eley and **seconded** by Mr. Ball to approve the Consent Agenda. The **motion carried unanimously.**

C-1 COMMITTEE MEETING:

Approval of Meeting and Minutes

Investment Manager Monitoring Subcommittee Meeting

December 6, 2018

Recommendation: Authorize meeting and approve minutes.

A. INDIVIDUAL MANAGER PRESENTATIONS

Mr. Beeson provided a brief overview of the meeting, noting the new presentation and reporting structure of the Investment Manager Monitoring Subcommittee (IMMS) meeting.

Mr. Beeson stated that the new presentation structure reflects Ms. Murphy's recent restructuring of portfolio coverage. With Ms. Murphy's modified generalist approach with primary and secondary asset class coverage, he reported that equities now fall under the primary purview of Mr. Cuaresma. Since emerging market (EM) equity strategies have recently underperformed, Mr. Cuaresma would help steer the EM equity-focused IMMS discussion after these introductory comments.

Mr. Beeson described the day's presenting managers, Acadian Asset Management and William Blair. He particularly defined the complementary roles they play in OCERS' EM portfolio: Acadian is more quantitative-oriented with a value bias, while William Blair is more fundamentally oriented, with a high-quality growth bias. Despite the complementary and diversifying attributes, both underperformed the MSCI EM benchmark in 2018. He stated that staff is not recommending either manager to be placed on OCERS' Watch List; rather, given the significant volatility, both upside and downside, he reported that staff is closely monitoring both managers. As an example of the upside volatility in EM, he recalled that Acadian had presented at the April 2018 IMMS meeting for outperformance. Further, he commented upon the continued challenging environment afflicting essentially the entire active EM equity space: he reported that the MSCI EM benchmark ranked in the 30th percentile, i.e., 70% of active equity EM managers underperformed the benchmark. That in mind, he also reported that over the last 10 years, 64% of active managers have outperformed the EM benchmark.

Mr. Beeson also described the new IMMS reporting structure and staff's use of Backstop Solutions (Backstop). He stated that Backstop's CRM software efficiently streamlines staff's quantitative and qualitative due diligence efforts in one central location. Further, with this technology, staff has created an OCERS bespoke fund report that summarizes the manager and risk-return analytics in one report, thus replacing prior IMMS reports.

Mr. Beeson also described staff's new executive summary. With staff's highlighted commentary and questions, this summary would then guide the IMMS in strategically focusing on long-term risks, outliers, and themes that staff has for each respective manager.

Mr. Ball observed the possibility of significant tracking error if 64% of managers are outperforming the benchmark.

Ms. Murphy responded, noting that many EM managers have historically had significant off-benchmark exposure, particularly through investments in China.

Mr. Ball and Mr. Beeson noted that outperformers in 2018 in EM were generally underweight China.

Mr. Cuaresma provided a succinct summary update of OCERS' investments in Acadian. He reported that Acadian manages both a large cap and a small cap emerging market equity strategy on behalf of OCERS: (1) OCERS initially invested \$125 million in the larger cap strategy, Emerging Markets Equity II (EM II), in November 2013; (2) OCERS initially invested \$100 million in Acadian's EM Small Cap Equity Fund in June 2014. As of February 28, 2019, Acadian managed \$259.6 million in EM II and \$174.2 million in the Small Cap strategy for OCERS.

ACADIAN ASSET MANAGEMENT

Presentation by Scott J. Brymer, CFA & Richard O. Barry, CFA

Firm Update: Acadian manages approximately \$86.2 billion across many strategies and asset classes, with the majority of assets actively traded in the equity space.

Portfolio Strategy: As a quantitative-oriented firm, the manager processes hundreds of millions of pieces of data on a daily basis. The manager believes that fundamental oversight used systematically, from a bottoms-up and top-down basis, can more easily capture mispriced emerging market equities.

Market Overview/Outlook for 2019: Acadian believes that EM looks attractive given the growth and valuation profile. The manager explained that EM is growing between 4-5%, whereas the developed markets (DM) are growing around 2%. The manager also described that EM's valuations are relatively significantly cheaper compared to DM.

Performance: As of February 28, 2019, the EM II Fund has returned -14.8% net of fees over the trailing 12 months, versus -9.9% for the MSCI EM Index. Since OCERS' inception, this strategy has generated a 2.1% annualized return versus 2.6% for the benchmark.

As of the end of February 28, 2019, the EM Small Cap Fund has returned -15.4% net of fees over the trailing 12 months versus -14.3% for the MSCI Emerging Markets Small Cap Index. Since OCERS' inception, this strategy has generated a 4.4% annualized return versus 0.6% for the benchmark.

Mr. Barry provided an update on senior organizational changes at Acadian, including a review of Acadian's long-term succession strategy developed in 2012 that has continued through 2018 and 2019. Effective January 1, 2018, John Chisholm and Ross Dowd became co-CEOs of Acadian. The change was part of a long-term succession strategy developed in 2012, which designated Churchill Franklin as CEO for a set five-year term. On January 1, 2018, Churchill transitioned from the CEO role and became Chairman of Acadian. Also at that time, Brendan Bradley, Director of Portfolio Management and Deputy CIO, became co-CIO with John Chisholm. Brendan Bradley transitioned fully to CIO at the beginning of 2019.

Mr. Brymer discussed the various factors that drove their underperformance, including EM II's overweight allocation to Turkey and tilt towards smaller companies. He reported that smaller cap EM companies underperformed larger cap EM companies in 2018.

Mr. Delaney asked about Acadian's allocation to Turkey, observing that many of Turkey's issues occurred prior to 2018.

Mr. Brymer observed that Acadian's country models were neutral on Turkey from a country perspective. He described that Acadian's stock selection models, however, determined that various Turkish companies presented compelling opportunities from a bottoms-up perspective.

Mr. Delaney, Mr. Ball, and Mr. Brymer continued to discuss Acadian's investment rationale for allocating to Turkey given the ongoing geopolitical risks.

Mr. Delaney and Mr. Brymer discussed Venezuela's investment viability, given the country's predisposition to left-tail geopolitical risks.

Mr. Brymer observed that Acadian's top-down country models would have a negative view on Venezuela.

Mr. Eley noted that Acadian's upside performance resembles performance of more growth-oriented strategies. He observed, similarly, that Acadian's downside performance resembles growth-oriented strategies – he asked about this lack of downside protection and defensive nature since Acadian's has a value bias.

Mr. Brymer responded, noting that Acadian's factor models include value, growth, quality, and technical factors. He noted that while the portfolio will have a heavy value tilt, the portfolio would still have positive exposure to quality, growth and price momentum characteristics. Ultimately, he reported that Acadian manages the portfolio's beta to one; therefore, Acadian does not explicitly factor downside protection. While Acadian thinks about capital preservation at all times, he described that diversification and a focus on the long-term market dynamics are their primary risk management tools.

Mr. Ball asked about Acadian's tracking error and their off-benchmark exposure.

Mr. Brymer responded that the portfolio is managed according to +/- 5% guidelines at both the country and sector level relative to the benchmark.

Mr. Ball asked about Acadian's currency attribution in 2018.

Mr. Brymer responded that Acadian's allocation to the Turkish Lira was a significant detractor. He also reported that the Lira was a more meaningful driver of underperformance in their EM II Fund versus in their Small Cap Fund.

Mr. Ball asked for Acadian's outlook on global growth and its impact on the emerging markets, particularly if the U.S. stalls to 1.5%, Europe to 1%, and China to 3%.

Mr. Brymer responded that over the long-term, Acadian's views would not change, as EM's growth trajectory coupled with the attractive valuations would lead to relative outperformance.

Mr. Eley, Mr. Ball, Mr. Beeson, and Mr. Cuaresma evaluated systematic investment strategies. They discussed the importance of qualitative overlays and how geopolitical risks concerns may not be appropriately priced-in their rules-based investment processes, which oftentimes can lead to short-term underperformance.

Mr. Eley, Mr. Ball, and Mr. Cuaresma evaluated developed growth concerns and how that would axiomatically influence the growth of the emerging markets.

Mr. Ball and Ms. Murphy discussed the short-term and long-term dynamics within the EM space, particularly focusing that 2018 country allocations were the biggest drivers of Acadian's and William Blair's underperformance. They discussed the trade-offs of investing in EM, given volatility, political and currency risks.

Mr. Ball and Ms. Murphy continued to evaluate how systematic quant-based managers evaluate political risks.

Ms. Murphy observed that while systematic managers' country models may arrive at a neutral weighting despite the country's geopolitical headwinds, overweight stock selection models might invariably outperform, as sometimes the mere absence of bad country news can be good news.

WILLIAM BLAIR

Presentation by Todd M. McClone, CFA & Stephen J. Weeks

The key highlights of the presentation were:

Firm Update: William Blair manages about \$49 billion across a number of asset classes, with the majority of assets actively managed in equities. They manage approximately \$9 billion in EM equities.

Market Overview/Outlook for 2019: The manager is optimistic on EM, as EM valuations are particularly compelling relative to DM. The manager also observed that currency headwinds have subsided in light of the weaker dollar and weakening, if any, pressure for the Federal Reserve to raise rates. The manager is particularly constructive on China due to a number of tailwinds: the domestic economy is improving, earnings are re-accelerating, and valuations have bottomed-out. The manager also observed that China is materially under-owned on a global basis. While 2016 was also a challenging year for William Blair due to a value-driven rally sparked by infrastructure spending, 2019 is shaping up to be a growth rally driven by tax cuts – the manager explained that consumption growth particularly lends itself to their portfolio's outperformance.

Portfolio Strategy: William Blair invests in high-quality growth companies that tend to be leaders in their industry. Such companies benefit from consistent earnings growth – and though these targeted companies are growing fast, these companies are still re-investing in themselves to achieve organic growth.

Performance: In 2018, William Blair declined -20.8% net of fees, compared to the MSCI EM's return of -14.6%. Since OCERS' initial investment, William Blair has marginally underperformed the benchmark, 4.8% versus the benchmark's 5.1% return.

Mr. Weeks introduced William Blair's Mr. McClone, who has helped managed the firm's EM strategy since 2000.

Mr. McClone reported that William Blair's performance actually was in-line with the benchmark through July 2018; he reported 2018's underperformance primarily occurred during the 3rd quarter, falling -8%, versus the benchmark's -1%. He explained that Growth underperformed Value, and in particular, China and China-related themes, significantly trailed the broad EM universe.

Mr. McClone further described the wild swings in the China and China A-share market due to erratic retail sentiment and investment flows, as well as regulatory risks particularly within the gaming, education, and healthcare industries. He noted that much of this regulatory overhang in has since been lifted. He also observed that the strenuous trade relationship between the U.S. and China also clearly detracted from their performance.

Mr. Ball and Mr. McClone evaluated William Blair's overweight/underweight exposures relative to the MSCI EM benchmark, particularly in the China and China-A share markets.

Mr. McClone explained that the portfolio was actually underweight China. He stated that a confluence of headwinds hit the portfolio during the 3rd quarter. He further noted that William Blair used the rapid decline to lean into their favorite names and the portfolio has since moved towards an overweight allocation to China, and in particular, to China A-share companies.

Mr. Ball asked about William Blair's use of quantitative technical analysis as well as rules-based systematic investment decisions relative versus a qualitative analysis of the macro and micro picture.

Mr. McClone responded that William Blair is approximately 80% bottom-up, fundamental stock pickers, and 20% macro top-down driven. He described that the investment process relies on quantitative analysis to narrow down the EM universe into an investable universe of high-quality growth companies characterized by high ROA, high FCF, and other metrics. He explained that the investment team then has to undergo bottom-up due diligence to verify first hand if those quality growth metrics are accelerating to the downside or upside. Overall, he rationalized that while there are many interesting charts in their presentation, charts do not drive their stock selection - they are only used as a top-down view of how the portfolio arrived through their bottom-up due diligence.

Mr. Ball asked about William Blair's Asia ex-China exposure relative to the benchmark.

Mr. McClone responded that the portfolio's concentration was slightly overweight in certain areas, particularly India. He explained that they tend to be overweight in India due to the country's abundance of high quality companies.

Mr. Ball and Mr. McClone discussed William Blair's benchmark.

Mr. McClone explained that the strategy uses the MSCI IMI because this broader investable index includes small, medium, and large cap companies, as well as the frontier markets.

Mr. Ball and Mr. McClone discussed the geo-political and economic relationship between the U.S. and China.

Mr. Ball and Mr. McClone discussed the dynamics of a free economy versus a command economy, particularly as it concerns China's control of the money supply and issues of repatriation.

Ms. Murphy observed that staff has operated with custom benchmarks to incorporate their non-benchmark exposure. She explained that staff monitors off-benchmark exposure.

Mr. Beeson noted the importance of understanding the current portfolio's benchmark and off-benchmark exposures, particularly with respect to performance and risk attribution, but also with respect to potentially moving forward with new investment managers.

Mr. Ball expressed agreement. He also expressed agreement with Ms. Murphy's new structure and asset class oversight, noting that the portfolio, structure, and oversight are all heading in the in right direction.

PUBLIC COMMENTS:

None

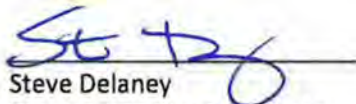
COMMITTEE MEMBER/STAFF COMMENTS:

None

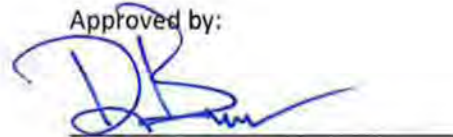
ADJOURNMENT:

The Chair adjourned the meeting at 3:25 p.m.

Submitted by:


Steve Delaney
Secretary to the Committee

Approved by:


David Ball
Chair