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

INVESTMENT MANAGER MONITORING
SUBCOMMITTEE MEETING
June 1, 2017
9:00 A.M.

MINUTES

The Chair called the meeting to order at 9:02 a.m. and read the opening statement into the record. Attendance was as follows:

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

Also present: Steve Delaney, Chief Executive Officer; David Beeson, Investment Officer; Adam Cheng, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Javier Lara, Visual Technician; and Julius Cuaresma, Recording Secretary

A. INDIVIDUAL MANAGER PRESENTATIONS

Mr. Beeson introduced AQR Capital Management (AQR), a systematic quantitative investment firm that manages approximately $270 million (as of April 30, 2017) on behalf of OCERS through an international large cap equity portfolio. OCERS initially invested in AQR in February 2007.

AQR CAPITAL MANAGEMENT
Presentation by Christian Doheny, CFA & Iwan Djanali

The key highlights of the presentation were:

Firm update: As of March 31, 2017, AQR managed about $188 billion through benchmark oriented equity strategies, and both alternative total return and absolute return strategies.

Market Overview/Outlook for 2017: As of March 31, 2017, relative to AQR's benchmark MSCI EAFE, AQR was overweight the cyclicals space, i.e., materials and technology, while underweight more of the defensive-oriented sectors, i.e., consumer staples, healthcare, and telecom. Year-over-year, AQR shifted from a neutral weight U.S. positioning to currently more of a relatively underweight positioning. Conversely, the manager shifted from a neutral weight positioning on Japan to a relatively more overweight positioning.

Portfolio Strategy: AQR's strategy seeks to generate alpha through three sources: 1. stock selection (active long-only management of stocks and sector weights); 2. country selection (active long-short management of stock index futures and swaps); and 3. currency selection (active long-short management through currency forwards).

Performance: Since OCERS' initial investment in February 2007, AQR has generated a gross cumulative return of 34.8%, whereas the MSCI EAFE has returned 14.8%. This gross excess return of 20.1% was driven primarily by stock selection, 16.6% and currency selection, 3.2%.

Mr. Packard, Mr. Djanali, and Mr. Doheny discussed the roles and titles of principals and managing directors.

Mr. Doheny also indicated that principals are equity owners, while managing directors are the most senior employees.

Mr. Eley asked about Cliff Asness, the managing and founding principal of AQR, and his day-to-day role at the firm.

Mr. Djanali responded that Mr. Asness is involved in research as well as involved in the firm's strategic planning committee.

Mr. Doheny also observed that since AQR is a systematic quantitative firm, there is no need for Mr. Asness to approve or reject a trade.

Mr. Baldwin asked about AQR's outlier negative performance attribution from their industrial sectoral allocation.

Mr. Doheny responded that AQR, within stock selection, held more of the weaker performing industrial companies, specifically mining and materials companies.

Mr. Eley and Mr. Mr. Doheny discussed AQR's portfolio leverage, specifically through AQR's use of futures and swaps.

Mr. Baldwin and Mr. Doheny discussed AQR's country exposure, including their allocation to Australia, and the rationale behind expressing country views through index futures and swaps.

Mr. Doheny also noted that their country exposure enables AQR in holding onto relative winners longer. Further, he reported that AQR can trade more frequently and more cheaply through derivatives relative to underlying stocks.

Mr. Djanli also observed that AQR can express bearish views through derivatives.

Mr. Stephen Weintrobski, Mission Viejo, addressed the Committee about AQR's fees for separate accounts and commingled funds.

The Committee recessed at 10:07 a.m.

The Committee reconvened at 10:22 a.m.

CAPITAL GROUP
Presentation by Gerald Du Manoir, Steve Caruthers, CFA, & Vincent Ortega

Mr. Beeson introduced Capital Group (Capital), an investment firm that manages approximately $260 million (as of April 30, 2017) on behalf of OCERS through an international large cap equity portfolio. OCERS initially invested in Capital in October 1989. Relative to AQR and its systematic quantitative investment style, Mr. Beeson remarked that Capital is a more bottoms-up, fundamental research oriented firm where Capital uses a multiple portfolio manager system (MPMS) to identify investments.

Mr. Beeson reported that in June 2015, OCERS placed Capital's international equity mandate on watch list for change in key personnel as Capital's portfolio management team diminished from seven portfolio managers (at the onset of 2015) to four. Over the past two years since then, he stated that the four-person portfolio manager team has remained stable. Further, there has been strong relative net of fees performance versus the benchmark, MSCI EAFE, over the last one and two-year periods, with outperformance over the benchmark by 3.4% and 1.0%, respectively.

The key highlights of the presentation were:

Firm update: Capital, a firm that dates back to 1931, manages approximately $1.5 trillion as of the end of December 2016.

Market Overview/Outlook for 2017: Though the U.S. equity markets have done well, the manager observed that international equity markets have outperformed U.S. markets in 2017. The manager reported that approximately 10 years has passed since international equity markets have outperformed U.S. ones, describing that from 2002 – 2007, international markets outperformed U.S. markets by over 80%. The manager also remarked that any country tied to oil is lagging (i.e., Russia, Canada).

Portfolio Strategy: Capital uses a MPMS investment process, supported by analysts and the analysts' "research portfolio." This portfolio empowers the analysts to be portfolio managers and enables the analysts the value of portfolio construction and position conviction. The research portfolio represents approximately 20% of the entire portfolio.

Performance: Capital has returned 14.2% net of fees on a trailing year basis through March 31, 2017; MSCI EAFE has returned 11.7%. The manager reported that information technology (IT) names and select financials has been a key driver of performance, particularly over the last 3 and 5 years. From the 4th quarter of 2016 into the 1st quarter of 2017, Capital rotated out of cyclicals into IT. This rotation was initially a headwind but presently is a tailwind to the portfolio's performance.

Mr. Baldwin asked about Capital's thoughts on Environmental, Social, and Governance (ESG) investing.

Mr. Manoir responded that environmental sensitivity is integral to their investment process, discussing their three lenses: 1. governance; 2. long-term opportunities; and 3. replacement opportunities. Capital is sensitive of their invested companies' governance and environmental policies. Capital's fundamental long-term investment philosophy requires them to understand and know the future opportunity set and cost structure of every investable company. In looking at replacement opportunities, he noted that the portfolio is positioned more in energy management, i.e., grid management, rather than in new energy. As an example, he described how Japan's efficiency attached to output is relatively higher and better compared to the U.S., which leads to a better ability in managing their use of renewables, which in turn, improves their cost structure.

Mr. Eley asked for Capital's thoughts on Japan.

Mr. Manoir responded that they are relatively underweight Japan, largely due to their belief that Japan will not be able to successfully reflate the economy. Capital is underweight Japanese financials as Capital does not subscribe to the notion that higher interest rates will translate into higher net margins. He stated that Capital has some IT and consumer (i.e. convenient stores) exposure in Japan.

Mr. Eley asked for Capital's thoughts on Capital's relative outperformance since the MPMS team diminished from seven portfolio managers to four.

Mr. Manoir responded that the performance is more of a by-product of Capital tightening their portfolio objectives and construction, noting that there is a higher hurdle for names to enter into the portfolio. He stated that Capital is exiting positions faster that deviate from their original thesis and recycling that capital into better ideas. He observed that Capital is unsure of the ideal number of portfolio managers, noting that the research portfolio itself is an additional portfolio manager.

Mr. Stephen Weintrobski, Mission Viejo, addressed the Committee about Capital's presentation, performance (specifically germane to quartile comparison), and portfolio (specifically pertaining to energy and ESG).

A **motion** was made by Mr. Baldwin and **seconded** by Mr. Packard to receive and file the manager presentations. The **motion carried unanimously.**

PUBLIC COMMENTS:
None

COMMITTEE MEMBER COMMENTS:
Mr. Dewane asked about OCERS' watch list process, and the possible removal of Capital from watch list.

Mr. Beeson responded that with guidance from the Investment Manager Monitoring Subcommittee (IMMS), staff can bring Capital's watch list status to the next Investment Committee meeting as an i-item. He commented that Capital's portfolio management team and performance has been stable, so staff is comfortable with taking Capital off watch list.

CHIEF EXECUTIVE OFFICER/STAFF COMMENTS:
Mr. Beeson reminded the Committee that the July 13 IMMS meeting is cancelled since OCERS is reducing the number of investment strategies in the portfolio by approximately 16, and therefore it is not necessary to have 10 IMMS meetings this year.

Mr. Beeson also noted, in response to Mr. Dewane's PIMCO overlap request from the prior April IMMS meeting, that PIMCO's average cross-correlation among OCERS' five invested strategies is 0.04.

Mr. Dewane stated that his rationale for his request was that investing in multiple funds within one firm may equate into significant overlap between each fund, and thus provide little to no diversification benefits. He stated this did not appear to be the case with OCERS' investments with PIMCO.

COUNSEL COMMENTS:
None

ADJOURNMENT:
The Chair adjourned the meeting at 11:31 a.m.

Submitted by:	Approved by:
Steve Delaney	Frank Eley
Secretary to the Committee	Chair