

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

**INVESTMENT COMMITTEE MEETING
May 24, 2018**

MINUTES

Attendance was as follows:

Present: Frank Eley; Vice Chair; Charles Packard; Chris Prevatt; Roger Hilton; David Ball; Russell Baldwin; Shari Freidenrich; and Eric Gilbert

Absent: Wayne Lindholm, Chair and 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

Meketa Investment Group: Stephen McCourt, CFA; Laura Wirick, CFA, CAIA
Pension Consulting Alliance: Allan Emkin; and Colin Bebee, CFA

The Vice Chair called the meeting to order at 9:09 a.m. Mr. Hilton 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. Hilton to approve the Consent Agenda. The **motion carried unanimously.**

Ms. Freidenrich and Mr. Gilbert arrived at 9:12 a.m.

C-1 COMMITTEE MEETING:

Approval of Meeting and Minutes
Investment Committee Meeting

April 24, 2018

Recommendation: Authorize meeting and approve minutes.

CIO COMMENTS

Ms. Murphy provided commentary on the capital markets.

Ms. Murphy provided an update on OCERS' private equity program, including a discussion on Pantheon.

Mr. Eley and Ms. Murphy discussed the currency markets, including the benefits and costs of tactical versus strategic hedging as it relates to the EUR-USD.

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 WATCH LIST - ASB CAPITAL MANAGEMENT & PICTET ASSET MANAGEMENT

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

Ms. Murphy discussed the rationale behind placing ASB and Pictet on Watch List.

Mr. Ball and Ms. Murphy compared the relative advantages and disadvantages between open-end and closed-end fund structures.

Mr. Baldwin and Ms. Murphy discussed the current and prospective emerging market debt opportunity set.

Ms. Freidenrich and Ms. Murphy discussed Townsend Group's (Townsend) investment process, particularly as it relates to their investment memos.

Jennifer Stevens Young, Townsend, addressed the Committee about Townsend's investment process and their investment memos.

Mr. Prevatt and Ms. Murphy discussed the Watch List process, specifically as it concerns a manager's possible duration on the Watch List.

Ms. Murphy discussed staff's work with Townsend on reviewing the fund structures, performance, and leverage levels for all real estate managers.

Mr. Eley asked about Meketa's quarterly Portfolio Evaluation Report, particularly as it concerns performance reporting.

Mr. McCourt and Ms. Murphy responded and discussed the appropriate performance reporting for closed-end and open-end funds.

Mr. Ball and Ms. Murphy reviewed the process for placing managers on Watch List, as well as the removal process.

Ms. Murphy also discussed the Investment Manager Monitoring Subcommittee meeting process, noting that presenting managers would be ones that are on exception, i.e., outperforming, underperforming, on Watch List, or have a material change at the organization level.

Mr. Ball and Ms. Murphy discussed exceptions to the Watch List process, including time-sensitive situations, i.e., a key man structure change.

A **motion** was made by Mr. Ball and **seconded** by Mr. Packard to place ASB & Pictet on Watch List. The **motion carried 7-0** with voting as follows:

<u>AYES</u>	<u>NAYS</u>	<u>ABSTAIN</u>	<u>ABSENT</u>
Mr. Packard			Mr. Dewane
Mr. Prevatt			Chair Lindholm
Ms. Freidenrich			
Mr. Ball			
Mr. Hilton			
Mr. Baldwin			
Vice Chair Eley			

A-3 REAL ESTATE OVERVIEW & PROGRAM PLAN FOR OCERS

Presentation by Jennifer Young Stevens & Robert Miranda, Townsend Group

Ms. Murphy introduced Jennifer Young Stevens and Robert Miranda of the Townsend Group (Townsend).

Ms. Stevens presented Townsend’s view of the markets. She noted the stretched valuations across all assets classes, including real estate.

Ms. Stevens and Mr. Ball discussed real estate asset flows, specifically as it concerns core and non-core assets.

Mr. Ball warned against rushing into any pacing plan; he also noted the need to have a plan where to park the un-invested assets.

Ms. Stevens discussed Townsend’s recommendation for OCERS to focus on managers that have both preserved and increased income.

Mr. Miranda continued this discussion, observing core’s flight to quality, safe haven characteristics, and their consistent ability to generate income across market cycles, particularly from 2000 - 2016.

Mr. Hilton asked for definitions for real estate terminology, including value-add and opportunistic.

Ms. Stevens responded and described Townsend’s definitions of core, core plus, value-add, and opportunistic.

Ms. Freidenrich expressed comfort with Townsend’s recommended targets and ranges, noting her preference to a portfolio positioned conservatively.

Ms. Stevens noted that Townsend’s recommended rebalancing program for OCERS is intentionally measured, and not a wholesale transfer of core into riskier real estate assets.

Mr. Ball and Ms. Stevens discussed Townsend's real estate definitions relative to his definitions, particularly core. They discussed OCERS' non-core exposures possibly masked as core exposures, particularly as it concerns vacancy rates.

Ms. Stevens discussed real estate themes, outliers, opportunities, and risks across the globe by sector (office, industrial, retail, and residential). She particularly noted the supply-demand imbalance across industrial properties relative to previous market cycles.

Mr. Eley and Ms. Stevens discussed the global real estate asset universe, particularly Japan's opportunity set relative to the U.S.

Mr. Ball, Ms. Stevens, and Ms. Murphy discussed the global value-add opportunity set, specifically the associated currency risks.

Ms. Murphy observed the due diligence needed for international investments, including a discussion on contract law. She also discussed Fortress Japan.

Mr. Emkin discussed the role of private equity and real estate, specifically in relation to risk and return expectations.

Ms. Freidenrich discussed the currency risks associated with investing outside the U.S.

Ms. Murphy noted that while OCERS' portfolio is diversified geographically through other asset classes, and thus has currency risks through such assets, the real estate portfolio is predominantly U.S. focused. She expressed her preference to potentially invest 0 – 5% in non-U.S. real estate on an opportunistic basis. She explained that there are added risks for ex-U.S. real estate investments relative to U.S. ones, and therefore there are higher barriers to entry for an ex-U.S. investment. She stated that reserving a 0 – 5% allocation to best ideas outside the U.S. would require increased due diligence, including appropriate currency hedging as well as laws comparable to U.S. laws.

Mr. Delaney noted that staff and consultants cannot invest outside the U.S. without the Committee first approving Townsend's and staff's recommended targets, structure, and ranges, which might include a 0 - 5% allocation reserved for best ideas outside the U.S.

Mr. Eley and Mr. Ball expressed approval for Townsend's and staff's recommendations.

Mr. Eley discussed the importance of comparing potential investment opportunities relative to OCERS' current investments.

Mr. Packard, Mr. Ball, Ms. Stevens, and Mr. Miranda discussed OCERS' current ex-U.S. real estate exposures.

Mr. Prevatt and Mr. Emkin discussed the importance of defining and understanding the role of each asset class and manager relative to each other, i.e., diversifier or performance enhancer.

Mr. Emkin and Ms. Murphy continued the discussion of Fortress Japan, specifically the proper strategy classification for the manager on account of its opportunity set and risk-return expectations.

Mr. Ball asked Mr. Emkin if a shift from core to value-add to opportunistic-core is a shift to more private equity-like risk and returns.

Mr. Emkin expressed agreement.

Mr. Ball, Mr. Emkin, and Ms. Murphy discussed the correlation between global cap rates, interest rates, and equity valuations.

Ms. Freidenrich asked for possible hedging mechanisms for each asset class within the OCERS portfolio.

Ms. Murphy responded, describing the relatively easier mechanisms to hedge public market assets, while explaining the challenge in trying to hedge private market assets.

A **motion** was made by Mr. Ball and **seconded** by Mr. Baldwin to approve the preliminary plan for real estate commitments, structure, and ranges.

Mr. Ball expressed the need for more education, information and frequent communication between consultants, staff, and the Committee.

Ms. Murphy provided a detailed summary of Townsend's recommended preliminary plan for real estate commitments, structure, and ranges as the following:

- (1) Overall real estate portfolio: tactically re-balance the portfolio towards a 60/40 mix of Core/Non-Core, with +/-10% ranges;
 - a. Fund Structures: Rebalancing the open-end core funds;
- (2) Geography:
 - a. 95% or more in U.S. focused assets, with up to 5% in best idea opportunities in ex-U.S. assets.
 - b. Within the U.S., overweight the West, and underweight the other U.S. regions
- (3) Sector: Overweight industrial and underweight office;
- (4) Commitment Sizing: target new commitments with a range of \$75 million - \$125 million

Ms. Freidenrich asked for more details, particularly with regards to where OCERS' real estate portfolio presently is and where it could be heading on account of Townsend's recommendations.

Ms. Stevens initiated Townsend's preliminary real estate investment plan presentation. She particularly described that Townsend's recommended portfolio rebalancing to a 60/40 mix of core/non-core assets is a move towards a more conservative portfolio. She also explained their goal of avoiding manager proliferation, particularly within core – for example, she stated that 0 – 3 new core open-end commitments would come at the expense of rebalancing activities and/or redemptions from existing managers. Regarding non-core, she noted the target would be \$75 million or more commitments, again in order to have a concentrated portfolio.

Mr. Delaney and Mr. Eley suggested that the maker of the motion modify their motion to reflect Townsend's recommendations as outlined in the Executive Summary of Townsend's presentation on slides 3 – 6.

Mr. Ball modified his motion to reflect Townsend's recommendations as outlined in the Executive Summary of Townsend's presentation on slides 3 – 6.

Mr. Baldwin expressed agreement with the modified motion.

Mr. Hilton expressed his preference to stay on track for a 50/50 mix between core/non-core. He also expressed his preference for a higher allocation to international real estate opportunities, suggesting that a 0 – 5% allocation is immaterial and a waste of time.

Mr. Baldwin expressed agreement with Mr. Hilton’s comments regarding a larger allocation than 0 – 5% in international real estate opportunities, but also noted that he did agree that it was at least a step in the right direction.

Ms. Murphy noted that OCERS could shift the target later, stating the importance right now is to be cautious because of the current market cycle.

After further discussion, a **motion** was made by Mr. Ball and **seconded** by Mr. Baldwin to approve the preliminary plan for real estate commitments, structure, and ranges as the following:

- (1) Overall real estate portfolio: tactically re-balance the portfolio towards a 60/40 mix of Core/Non-Core, with +/-10% ranges;
 - a. Fund Structures: Rebalancing the open-end core funds;
 - (2) Geography:
 - a. 95% or more in U.S. focused assets, with up to 5% in best idea opportunities in ex-U.S. assets.
 - b. Within the U.S., overweight the West, and underweight the other U.S. regions
 - (3) Sector: Overweight industrial and underweight office;
 - (4) Commitment Sizing: target core commitments in the range of \$75 million to \$150+ million; relative to core, target smaller non-core commitments that may average \$75 million;
 - (5) Manager Concentration: limit concentration to 15% of the overall private real estate program
- The **motion carried 7-0** with voting as follows:

<u>AYES</u>	<u>NAYS</u>	<u>ABSTAIN</u>	<u>ABSENT</u>
Mr. Packard			Mr. Dewane
Mr. Prevatt			Chair Lindholm
Ms. Freidenrich			
Mr. Ball			
Mr. Hilton			
Mr. Baldwin			
Vice Chair Eley			

The Committee recessed at 10:53 a.m.

The Committee reconvened at 11:10 a.m.

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 MANAGER ACTIVITY

Written report only

I-5 4th QUARTER 2017 REAL ESTATE PERFORMANCE REPORT

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

Mr. McCourt and Ms. Wirick presented Meketa's 4th Quarter 2017 Real Estate Performance Report for OCERS' portfolio.

Mr. McCourt discussed the performance for OCERS' closed-end funds.

Mr. McCourt expressed comfort with the approved real estate mix recommended by Townsend and staff.

I-6 1st QUARTER 2018 PORTFOLIO RISK DISCUSSION

Presentation by Allan Emkin & Colin Beebe, CFA, PCA

Mr. Emkin and Mr. Beebe presented PCA's 1st Quarter 2018 Portfolio Risk Discussion for OCERS' portfolio.

Mr. Beebe reminded the Committee that this Portfolio Risk Discussion presentation is geared towards the OCERS' liquid portfolio.

Mr. Beebe 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 PCA needs to continue working with Meketa and staff to properly build out the 5% allocation.

Mr. Ball, Mr. Beebe, and Ms. Murphy discussed the performance of the RMS portfolio.

Mr. Emkin discussed: (1) pockets of inflation in the market place that are rising and could sooner than later impact economic growth; and (2) unquantifiable and uncontrollable risks.

Mr. Emkin described OCERS' enviable liquid and positive cash flow position, observing that OCERS has the ability to capitalize on market dislocations. He opined that it is easier to discuss and formulate the process how OCERS will capitalize on dislocations now, rather than when the crisis actually hits.

Mr. Ball and Mr. Emkin discussed the role of RMS across market cycles, including periods of inflation, stagflation, and deflation.

Mr. Ball and Mr. Emkin continued the discussion on market dislocations and processes by which allocators can capitalize on such dislocations.

Mr. Emkin discussed various processes, including having a pre-determined hierarchy of assets to buy/sell when there is a market dislocation.

I-7 REPORTS - PORTFOLIO ACTIVITY & COMPLIANCE

Presentation by Molly Murphy, CFA, CIO & Shanta Chary, DIO, OCERS

Ms. Chary presented the portfolio activity report, including the total fund overview, subscriptions and redemptions, as well as the asset allocation for April 2018.

I-8 1st QUARTER 2018 PORTFOLIO EVALUATION REPORT

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

Mr. McCourt presented Meketa's 1st Quarter 2018 Portfolio Evaluation Report for OCERS' portfolio.

Mr. McCourt noted that performance reporting has unfairly measured OCERS' performance: OCERS is reported on a net of fee basis, while the benchmark is gross.

Mr. McCourt, in an effort to present Meketa's report in a more forward-looking manner, discussed current market characteristics and what Meketa, along with staff, is working on, or planning on working on. This discussion with the Committee and staff included:

- (1) Stagflation and Real Assets (RA): recent market stagflation, OCERS' performance in this time period and sourcing the appropriate RA managers that could protect the portfolio during such an environment;
- (2) RMS and Volatility: using RMS not necessarily as a defensive tool but an offensive tool, given OCERS' long-term nature. Higher volatility is nonetheless a return to average volatility levels. Mr. McCourt observed that there is good evidence that in low vol regimes, passive investment managers outperform, while in higher vol regimes, active investment managers outperform. Meketa and staff are working on appropriate responses to the heightened volatility, such as possibly tilting the portfolio to more active managers and increasing RMS to 10%;
- (3) Portfolio concentration: finding the optimal number of managers relative to performance generated and fees incurred, on an alpha and beta basis;
- (4) Emerging Market Debt: finding the optimal structure of this asset class

Ms. Wirick discussed outperforming and underperforming assets.

Ms. Wirick and Mr. Baldwin discussed Meketa's standard performance reporting, as well as, IRR measures for OCERS' private equity portfolio.

Mr. Baldwin, Ms. Wirick, and Mr. McCourt discussed the London Interbank Overnight Rate (LIBOR), and the rationale behind the new rates, the Secured Overnight Financing Rate (SOFR) and the Sterling Overnight Interbank Average Rate (SONIA).

Ms. Wirick also noted that while Meketa has discussed the aforementioned rates with Fixed Income managers, there was no explicit conclusion to draw upon – she observed that market participants are generally in watch and monitor mode due to widespread uncertainty.

*** * * * *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

Ms. Freidenrich noted that although she is more conservative and more risk averse, she expressed her support for the changes implemented by OCERS' consultants and staff.

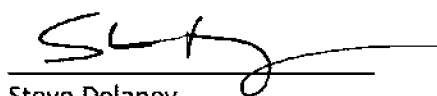
Mr. Eley noted the importance of a Committee that is balanced across risk tolerance levels.

COUNSEL COMMENTS

None

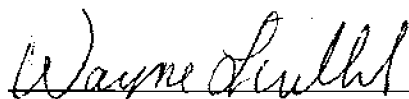
ADJOURNMENT: The Vice Chair adjourned the meeting at 12:05 p.m.

Submitted by:



Steve Delaney
Secretary to the Committee

Approved by:



Wayne Lindholm
Chair