

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

**INVESTMENT MANAGER MONITORING
SUBCOMMITTEE MEETING**

**December 6, 2018
9:00 A.M.**

MINUTES

The Chair called the meeting to order at 9:04 a.m. and read the opening statement into the record. Attendance was as follows:

Present: Charles Packard, Chair; Russell Baldwin, Vice Chair; Frank Eley; 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; Anthony Beltran, Visual Technician; and Cammy Danciu, Recording Secretary

A. INDIVIDUAL MANAGER PRESENTATIONS

Mr. Beeson introduced Eagle Asset Management (Eagle). OCERS initially invested in October 2010 in Eagle's long-only U.S. Small Cap Growth strategy. Eagle manages \$205.7 million on behalf of OCERS. Over the trailing 12 months through October 31, 2018, Eagle has returned 11.1% versus 4.1% for its benchmark, Russell 2000 Growth Index.

Mr. Packard, Mr. Beeson, and Ms. Murphy discussed Eagle's recent performance in light of the recent equity market price action.

Mr. Beeson and Mr. Packard discussed potential retirement concerns surrounding Eagle's Bert Boksen, managing director and portfolio manager.

Mr. Beeson reported that Eagle, as part of their efforts to alleviate these concerns, hired David Cavanaugh as Senior Research Analyst in 2017.

EAGLE ASSET MANAGEMENT

Presentation by David Cavanaugh & Clay Lindsay

The key highlights of the presentation were:

Firm update: Eagle manages approximately \$33.6 billion in assets across its subsidiaries, with approximately \$8.4 billion in their Small Cap Growth strategy.

Market Overview/Outlook: The manager noted that Eagle's process and philosophy does not change during volatile markets. The current volatility has enabled Eagle to initiate new positions as well as to add to current ones.

Portfolio Strategy: Eagle aims to attain a long-term track record of consistent outperformance on a relative and risk-adjusted basis. Through proprietary screens and fundamental research, Eagle seeks durable companies that undergo a step-change in their earnings growth rate. This focus on durable growing companies enables Eagle to buy and hold onto their winners for an extended amount of time. Eagle's pro-active risk management includes continuous industry data collection that rejects or denies their original investment thesis.

Performance: For the trailing three and five years through October 31, 2018, the manager has outperformed the Russell 2000 Growth Index by 3.6% and 2.0%, respectively.

Mr. Lindsay remarked upon Meketa's and staff's concerns regarding Bert Boksen and his possible retirement. He particularly commented upon Mr. Cavanaugh's addition to the team, which lends itself into multiple sets of senior coverage on each invested sector in the portfolio.

Mr. Delaney and Mr. Cavanaugh compared Mr. Cavanaugh's prior investment experience relative to his current experience Eagle.

Mr. Cavanaugh also remarked upon the thorough mutual due diligence he and Eagle had done prior to his Eagle employment.

Mr. Packard and Mr. Cavanaugh discussed Eagle's liquidity position, particularly in light of the heightened volatility in the markets.

Mr. Baldwin, Mr. Packard, and Mr. Lindsay discussed Eagle's Environmental, Social, and Governance (ESG) investment process, including Eagle's recent steps in hiring an outside firm to help identify various ESG measures.

Mr. Lindsay also noted that while Eagle has no formal ESG policy, Eagle already implements countless forms of Governance in their stock selection process.

Mr. Eley and Mr. Cavanaugh discussed possible risks with Eagle's current sub-sector themes and potential fads in the portfolio.

Mr. Cavanaugh remarked upon Eagle's constant due diligence process and channel checking done to mitigate the amount of potential stock-specific risks.

Mr. Eley and Mr. Cavanaugh further discussed Eagle's growth-at-a-reasonable price (GARP) investment philosophy, particularly as it concerns Eagle's sell discipline.

Mr. Cavanaugh commented upon Eagle's iterative process in forecasting earnings over multiple years out. He also addressed situations where, when, and how Eagle's models would be materially different from the Street's models.

The Committee recessed at 9:54 a.m.

The Committee reconvened at 10:09 a.m.

Mr. Beeson introduced City of London (CLIM), an emerging market (EM) equity manager that invests approximately \$243 million on behalf of OCERS. He described that CLIM, rather than directly trading in underlying individual stocks, trades in closed-end funds that own EM stocks. He also noted that CLIM's portfolio will hold between 60-100 closed-end funds, each of which hold an average 60 securities, providing a total look-through exposure to 3,500 to 4,500 stocks.

Mr. Beeson described CLIM's recent subpar upside-downside capture, citing their absolute and relative underperformance. He reported that CLIM performed within staff's expectations in 2017, returning 35.8%, while its benchmark, the MSCI EM Index returned 37.3%. Year-to-date through the end of October 31, 2018, however, CLIM had declined -16.9%, versus the benchmark's return of -15.7%. That in mind, he also stated that since OCERS' initial investment in October 2013, CLIM has outperformed its benchmark, 1.8% vs. 0.8%.

Mr. Eley and Mr. Beeson discussed manager investment styles, namely styles expected to outperform coming out of a market pullback, i.e., aggressive, more growth-oriented managers, such as William Blair, and styles expected to outperform during market pullbacks, i.e., defensive-oriented managers such as CLIM. They continued to discuss how CLIM has recently not performed within expectations.

Mr. Dewane and Ms. Murphy discussed CLIM's fees and the costs and benefits of investing in CLIM.

Ms. Murphy discussed staff's fee presentation given earlier in the year and OCERS' ideal profit sharing split between OCERS and the GP.

Mr. Dewane and Ms. Murphy discussed the cyclical opportunity set of CLIM's investment universe.

CITY OF LONDON INVESTMENT MANAGEMENT COMPANY LIMITED

Presentation by Barry Olliff & Carlos Yuste

The key highlights of the presentation were:

Firm update: CLIM manages approximately \$5.0 billion, primarily for institutional investors. The manager remains closed to new investors.

Market Overview/Outlook: The manager is defensively positioned, with cash at the portfolio level ready to be deployed – further, the manager's underlying investments also have cash at hand. The manager is intentionally underweight China and Brazil, primarily due to each country's higher beta and volatility.

Portfolio strategy: The manager generates alpha by exploiting closed-end funds' intraday and intraweek volatility. This volatility enables the manager to buy closed-end funds perceived to be trading at a discount to net asset value (NAV). Historically, approximately 2/3 of the manager's performance is derived from this discount (bottom-up analysis of closed-end fund managers), with the balance from country allocations (utilizing proprietary top-down, macro EM country rankings).

Performance: The manager has declined -14.1% over the trailing 12 months versus -12.5% for the index. For the trailing three years, CLIM has returned 5.5%, lagging the index by 1.0%.

Mr. Olliff, Mr. Dewane, and Mr. Eley discussed current arbitrage opportunities that exist due to the imbalance of retail investors in the closed-end space relative to institutional investors. They also discussed arbitrage opportunities that exist due to differing tax regulations between various countries.

Mr. Olliff further described how CLIM seeks closed-end funds with shareholder friendly board members who provide good governance and undertake corporate actions (i.e., tender offerings, IPOs, rights offerings, buybacks, and distributions) that narrow the discount to NAV.

Mr. Dewane and Mr. Olliff discussed the typical market cycle of closed-end fund's performance as it concerns discounts and premiums to NAVs.

Mr. Baldwin and Mr. Olliff discussed CLIM's Environmental, Social, and Governance (ESG) process. The manager described their ESG investment process, noting they are a signatory to the UN PRI and collaborate with Sustainalytics.

Mr. Eley, Mr. Beeson, and Mr. Dewane discussed OCERS' EM portfolio and the overall EM opportunity set, particularly with respect to managers expected to underperform and outperform in varying EM regimes.

Ms. Murphy asked the Committee for their feedback, specifically as it concerns staff's investment process and the different roles and responsibilities between the Investment Committee (IC) and the Investment Manager Monitoring Subcommittee (IMMS).

Mr. Baldwin responded that ESG is his biggest concern – he, in turn, asked Ms. Murphy if staff discusses ESG with OCERS' investment managers outside of these IMMS meetings, i.e., during typical due diligence meetings.

Ms. Murphy responded that during the course of a year staff undertakes approximately 300 due diligence manager meetings – in these meetings, staff naturally reviews ESG with the managers. She explained, however, that staff has not prioritized ESG because it is not a specific mandate required from the IC or the IMMS. Further, she remarked that staff is not necessarily using this IMMS meeting to further staff's normal manager due diligence process, but rather staff uses this meeting for the Committee's guidance, thoughts, and concerns.

Mr. Baldwin opined that it would be helpful for the IMMS to hear stronger language and recommendations from staff regarding manager evaluations.

Ms. Murphy expressed agreement, noting that staff would bring forth stronger language and recommendations. She particularly commented upon the bifurcation of CLIM's performance: net of all CLIM's fees, the manager has outperformed its benchmark on a 5-year basis and underperformed on a 3-year basis. Consequently, staff is monitoring the manager closely – that said, she noted, that staff is monitoring the entire EM portfolio closely due to the volatile EM environment.

Mr. Eley remarked that the structure of the IMMS meeting is an efficient use of time for staff, for the IMMS and the IC. He explained that this Subcommittee's role of focusing at the sub or micro level, i.e., at the manager level enables the entire IC to focus at the macro level, i.e., the entire portfolio from a top-down, strategic perspective. He further explained that the highest utility of the

IMMS would be for staff to educate this Subcommittee and thus build support from the IMMS prior to manager selections and terminations done at the IC meetings.

Mr. Dewane opined that the best use of IMMS would be to support staff and to monitor managers by exception and not the rule.

Ms. Murphy responded, suggesting that she would lean away from routine, cyclical or formulaic manager presentations at IMMS meetings – she explained that staff intentionally brought both outperforming and underperforming managers to the IMMS.

Mr. Eley, Mr. Beeson, and Ms. Murphy discussed the IMMS meeting minutes approval process; since the IC was not present at the IMMS meeting, they concluded that IMMS meeting minutes should be approved at the following IMMS meeting, rather than at the next IC meeting. They also observed that other OCERS Subcommittees approved their respective meeting minutes at their next respective Subcommittee meeting, rather than at the full Regular Board Committee meeting.

PUBLIC COMMENTS:

None

COMMITTEE MEMBER/STAFF COMMENTS:

None

ADJOURNMENT:

The Chair adjourned the meeting at 11:25 a.m.

Submitted by:



Steve Delaney
Secretary to the Committee

Approved by:



David Ball
Chair