



MINUTES OF THE JULY 13, 2022 INVESTMENT COMMITTEE MEETING

THIS MEETING WAS CONDUCTED VIA TELECONFERENCE WITH VIDEO

To: Members of the Board of Retirement
From: Tarrell Gamble – Chair
Subject: Summary of July 13, 2022, Investment Committee Meeting

The Investment Committee (“Committee”) met on Wednesday, July 13, 2022, at 9:31 a.m. The Committee members present were Keith Carson, Tarrell Gamble, Jaime Godfrey, Henry Levy, Kellie Simon, and George Wood. Also present were Alternate Retired Member Nancy Reilly and Alternate Safety Member Darryl Walker. ACERA Senior Managers and Presenting Staff present were Dave Nelsen – Chief Executive Officer, Betty Tse – Chief Investment Officer, Jeff Rieger – Chief Counsel, Vijay Jagar – Chief Technology Officer, Harsh Jadhav – Chief of Internal Audit, and Thomas Taylor – Investment Officer.

Board Action Item:

1. Proposed Findings Regarding State of Emergency Pursuant to Gov’t Code §54953(e) (3): Staff Recommendation: The Board finds that it has reconsidered the circumstances of the state of emergency and (1) the state of emergency continues to directly impact the ability of the members to meet safely in person, and (2) state or local officials continue to impose or recommend measures to promote social distancing.
 - After a brief discussion, Trustee Godfrey Moved and Supervisor Carson seconded that the Board make the Proposed Findings.
 - The motion carried with 7 Yes (Carson, Gamble, Godfrey, Levy, Simon, Reilly and Wood) 0 No, and 0 Abstention. (Trustee Walker was not present at the time of voting)

Action Item: Matters for discussion and possible motion by the Committee

1. Interview of the Finalists for ACERA’s Emerging Markets Equity Manager Search – International Equities and Possible Motion by the Investment Committee to Recommend Finalist (s) to the Board
 - Staff and Verus presented to the Trustees the three finalist candidates¹ for the Emerging Markets Equity (EME) Manager Search – International Equities with the recommendation

¹ The three finalists: Baillie Gifford, Wellington Management, and William Blair

of William Blair's *Emerging Markets Growth* to replace the current EME manager, Newton Investment Management.

- Staff, Verus, and trustees briefly discussed the size of the mandate, the process followed for the on-site visits, the re-scoring, and function of Environment, Social, and Governance (ESG) in stock selection in emerging markets.
- Additionally, Staff made a verbal correction to its Memo: William Blair has \$17 billion (or 24% of total AUM) in EM AUM, not \$30.4 billion as stated. Furthermore, Staff stated that this correction did not change Staff's recommendation. William Blair scored the highest in all categories: Organization, Investment Team, and overall Performance. Additionally, the firm's communications system Summit affords the PMs, analysts, traders, operations and firm to seamlessly share information. Lastly, William Blair's fees are competitive with the others.
- Trustees ask about the relevance of hiring a replacement EME manager at a time with the financial markets down. If a new manager is hired, Staff will transition assets from the incumbent manager. ACERA is not looking to time the markets, however, the search finalists have all outperformed the current manager.

Ballie Gifford

- Representatives from Baillie Gifford presented the *Emerging Markets All Cap* strategy and provided an overview of their organization, investment team, investment strategy and decision-making process. Baillie Gifford is a 100% private partnership and operates as a unlimited liability corporation where the partners are personally liable for the operations of the company. The company has grown organically since 1908.
- The *Emerging Markets All Cap* strategy is managed by three investment managers: Mike Gush, Andrew Stobart and Ben Durrant. Baillie Gifford's investment philosophy leans on long-term growth, the private partnership that looks 5-years and beyond, active management accepting short-term volatility, and responsible investing by engaging with selected companies they make investments in. The investment manager (PMs) primary role is an analyst; the investment team is made up of 14 individuals.
- Baillie Gifford relies heavily on in-house research and independent research providers including academia, private companies and other investment managers. A deep understanding of the portfolio companies helps mitigate portfolio risk and with diversification. Security analysis is by country or region.
- Trustees discussed (Q&A) issues such as the effect of de-globalization on the portfolio, how under-appreciated growth opportunities are developed. In answer, Baillie Gifford shared how it uses its experience, its extensive research to work through the effects of de-globalization. Baillie Gifford state that it uses same investment process to uncover growth opportunities.
- Baillie Gifford shared their appreciation to participate in this selection process.

Wellington Management

- Representatives from Wellington Management presented the *Emerging Market Development* strategy and provided an overview of their organization, investment team, investment strategy and decision-making process. Wellington is a private company 100% owned by its partners. It operates as a collection of boutique team structure and facilitates both dedicated resources, as well as the firm's centralized resources. The strategy headquarters are in Singapore with 12 of its 15-analysts located in Asia. This enables the investment team to be in closer proximity to the companies they invest in –boots on the ground.
- The *Emerging Market Development* strategy is managed by two portfolio managers: Dáire Dunne and Simon Henry. The PMs are supported by two dedicated investment strategy analysts, 15 dedicated industry or sector analysts, as well as the centralized functions such as structural research, or ESG research. *Emerging Market Development* strategy is unique in that it uses a top-down, thematic approach before investing in stocks that fit into the theme.
- Wellington outlined the EM economic development opportunity through three focal points: Inclusion, Sustainability, and Innovation. Calling their approach as the 'next generation platform,' the strategy develops its portfolio themes that are sustainable over a 5-year time horizon. For example, "automation & robotics", or "environmental consciousness" make for opportunities that are under-represented in any of the EM indices that Wellington takes advantage of.
- Trustees discussed (Q&A) issues such as the effect the size of Wellington and if it affects its operating this strategy. Wellington pointed out that its size provided for greater economies to scale of resources and a stronger present in the financial markets. Wellington shared that it had incorporated practicing ESG before the UN Sustainable Development Goals were established. Trustees and representatives further discussed the purity of the portfolio and how the strategy will not invest in carbon, guns, or defense, for example.
- Wellington shared their appreciation to participate in this selection process.

William Blair

- Representatives from William Blair presented the *Emerging Markets Growth* strategy and provided an overview of their organization, investment team, investment strategy and decision-making process. William Blair is 100% active-employee owned by 58 partners and has an entrepreneurial investment-led culture that encourages diverse viewpoints.
- The *Emerging Markets Growth* strategy is managed by three portfolio managers: Todd McClone, Casey Preyss, and Vivian Lin Thurston. At the core of the investment team are

15 fundamental analysts supported by five strategists, four systematic research analysts, four portfolio specialist and seven global traders, as well as the firm's centralized resources. The *Emerging Markets Growth* strategy is an all-cap quality growth strategy across the capitalization structure and sectors. The team manages several EM strategies (similar to the other two candidates) and pulls some of the best ideas from other specific portfolio strategies, e.g., the EM Small Cap Growth or China A-Shares Growth. Communication and the flow of information between the PMs, analysts, strategist, traders, and the firm is all done on one proprietary platform (Summit).

- Trustees discussed (Q&A) issues such as William Blair's Investment Banking business, and separately, how the *Emerging Markets Growth* strategy fared in the last 12 months. The William Blair's Investment Banking is unrelated and there is no overlap between the two businesses. McClone exemplified the dynamics of its investment process including quantitative screen for quality and growth metrics and qualitative input from the global sector analysts. The investment process –and outcome lead the *Emerging Markets Growth* strategy to overweight China shortly as the country came out of COVID (2020) but underweighted the holdings as the Chinese government moved to restrict growth (2021). Another example is the investment team reduced holding to an underweight of any Russian securities and get out of before Russia invaded Ukraine.
- William Blair shared their appreciation to participate in this selection process.

Conclusion

- At the conclusion of the three presentations, Staff and Verus briefly talk about management fees and reiterated their recommendation, the size of the mandate (~\$260m), and the value of the U.S. Small Cap Growth account (~\$122.7 million) currently managed by William Blair. ACERA's CIO asked William Blair of what its average operating fee might be between 1 – 5 basis points. William Blair said its average is approximately 4 basis points.
- After further discussion, Treasurer Levy moved, seconded by Trustee Simon, to adopt Staff's recommendation to hire William Blair to replace the incumbent emerging markets equity manager, Newton Investment Management, pending completion of legal and investment due diligence and successful contract negotiations.
- The motion carried with 5 Yes (Gamble, Levy, Reilly, Simon, and Wood), 3 No (Carson, Godfrey, Walker), and 0 Abstention.

Information Items: These items are not presented for Committee action but consist of status updates and cyclical reports

1. Total Fund Recessionary/Inflationary Impact Review 2022-2027

- Staff and Verus provided context and comments regarding the ACERA Total Fund and the effects of the current volatile financial markets, with the highest inflation in four decades

and some speculations of a looming recession. As an all-weather portfolio, the ACERA Total Fund has performed relatively well returning -7.26% (preliminary) outperforming its Policy Index of -8.10% for the first five months of 2022, albeit with a lowered market value of \$10.8B compared to the \$11.9B recorded at the beginning of the year. Staff concurred with Verus' evaluations of maintaining the Total Fund's current Asset Allocation which was adopted in mid-2021.

- Verus believes it would be premature to consider making any changes at this juncture. Much of recent inflation shock effect has already been reflected in 2022 returns through June 30th. Trustees asked Verus about the current assumed rate of return to reflect a lower number. Verus' asset allocation analysis shows that taking risk off table now and adding more inflation hedging assets (i.e., TIPS) in reaction to current markets would result in lower expected returns over subsequent 10-yr horizon. Verus provided various risk model stress tests for different recessionary/inflationary scenarios for Trustees to review.

TRUSTEE REMARKS:

- Trustee Levy encouraged everyone to be comfortable having robust discussion regarding the decision factors influencing their position on the agenda items.

FUTURE DISCUSSION ITEMS

None

ESTABLISHMENT OF NEXT MEETING DATE

Wednesday, August 10, 2022

ADJOURNMENT

The meeting ended at 1:02 p.m.