



Date: March 8, 2017
To: Members of the Board of Retirement
From: Annette Cain-Darnes - Chair
Subject: **Summary of March 8, 2017 Investment Committee Meeting**

The Investment Committee met on Wednesday, March 8, 2017 at 9:34 a.m. The Committee members present were Ophelia Basgal, Annette Cain-Darnes (Chair), Keith Carson, Tarrell Gamble, Greg Lawson, Liz Koppenhaver, and Elizabeth Rogers. Also present were Alternate member Nancy Reilly and Alternate Safety member Darryl Walker. Members of the Staff present were David Nelsen – Chief Executive Officer, Margo Allen – Fiscal Services Officer, Betty Tse – Chief Investment Officer, and Susan Weiss – Associate Counsel.

ACTION ITEMS: Matters for discussion and possible motion by the Committee

There were no action items for discussion.

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

1. Report on ACERA's PEARLS Investment – Venture Capital

- Upon completion of all due diligence procedures and in accordance with ACERA's Private Equity and Alternatives Return Leading Strategy (PEARLS) Policy, and the 2015 - 2017 Investment Plan for ACERA's PEARLS Portfolio, Verus recommended and Staff approved an up to \$15.0 million commitment to NEA 16, L.P. ("NEA 16" or "Fund") as part of the Venture Capital allocation in ACERA's PEARLS portfolio, pending completion of legal due diligence, background checks, and successful contract negotiation.
- New Enterprise Associates (NEA) is an existing manager in good standing. This commitment is an extension of an existing strategy (NEA 13, 14, and 15) in ACERA's portfolio; the strategy is unchanged and will be managed by the same NEA staff members that manage NEA 13, 14 and 15. According to the Policy, a commitment of up to \$15 million is within Staff's delegated authority.
- Trustees asked questions about terms and vetting of the Fund. Staff responded that the GP's 1.25% management fees and 30% carry (incentive share of net new profits) were the same as they were in the three previous NEA funds named above. A Verus representative responded that Verus recommend a \$15 million commitment to the NEA 16 as opposed to a \$5 million commitment to NEA 15 because he found improved valuations for portfolio companies, than when he had vetted NEA 15.



2. Review and Discussion of ACERA Total Fund Policy Expectations using 2017 Capital Market Assumptions

- Verus representatives reviewed the Capital Market assumptions that they presented at the February ICM and discussed the impact those assumptions would have on the policy targets approved by the Board in August, 2015.
- By utilizing the approved policy allocations in the context of the Capital Market Assumptions, a projection was made that the rate of return for ACERA's portfolio would be approximately 6.63% for the forecast 10-year period.
- Based on the discussion that was held at the ICM, the Verus representatives also confirmed that the above-mentioned asset allocation approved by the Board is valid. There is no need for a revision.

3. Quarterly Performance Review for the Fourth Quarter of 2016 – Equities and Fixed Income

- Representatives reviewed Q4 and long-term performance of ACERA's Total Portfolio. For 4Q2016, ACERA's Total Fund returned 0.8% (gross) compared to the Policy Index return of 1.3%. For 2016, the Total Fund Returned 7.4% (gross) compared to the Policy Index return of 9.1%. The Total Fund's results ranked in the 52nd and 73rd percentiles for the quarter and one year periods, respectively.
- For 4Q2016, ACERA's U.S. Equity, International Equity, and Fixed Income asset classes returned 3.9%, -2.1%, and -3.2% (gross) compared to their benchmarks with returns of 4.2% (Russell 3000), -1.5% (MSCI ACWI ex USA IMI Gross), and -3.7% (a blend of: 75% Barclays Aggregate, 10% Barclays High Yield, and Citigroup WGBI ex US), respectively. On a 1-year basis, these asset classes returned 9.8%, 5.0%, and 6.2%, ranking in the 86th, 35th, and 37th percentiles, all respectively.
- As of 12/31/2016, U.S. Equity accounted for 33.3% of the Total Fund, International Equity 27.8%, and Fixed Income 16.1%. As of 12/31/2016, the market value of the Total Fund was \$6,968,046,520.
- Verus and Trustees discussed the drop in AUM over the past three years for the accounts managed by Next Century Growth Small Cap and, separately, the NCG Micro Cap portfolios. Verus pointed out NCG's historical pattern of big losses followed by bigger recoveries. Recently, NCG has done well in January. Trustees asked Staff to explore further and come up with a plan. Staff stated that it plans to review NCG at the May 10, 2017 ICM.



- From a policy perspective, Trustees also inquired about the function of the Watchlist and Probation. Verus and Staff briefly discussed the issue. The comments were acknowledged and it was suggested that this issue be further vetted as part of the review of the General Investment Guidelines, Policies and Procedures.

4. Quarterly Performance Review for the Fourth Quarter of 2016 – Real Estate

- ACERA's real estate portfolio returned 1.8% (gross) for the 4Q2016 and 8.4% (gross) for the 2016 compared to the NCREIF-ODCE benchmark of 2.1% and 8.8%, respectively.
- The total market value of ACERA's real estate portfolio was \$497.5 million, approximately 7.1% of ACERA's Total Fund.
- Callan Associates reported that, while returns have been driven by appreciation over the last few years, recent returns have been driven more by income. Callan currently considers this to be a healthy Real Estate Market.

5. Investment Committee Workplan

- Staff offered the proposed Investment Committee Workplan for 2017 (Workplan). On a quarterly basis, Staff will provide an updated Investment Committee Workplan. Trustee Cain-Darnes also asked the other trustees to give the CIO any comments they may have on the Workplan.

TRUSTEE/PUBLIC INPUT

- Betty Tse, Chief Investment Officer, welcomed Greg Lawson, representing the Treasurer Office of the County, to the Investment Committee.
- In response to Trustees December 14, 2016 question, Staff reported to the Committee the approximate net cost to invest the assets (cash) held in reserve to meet future capital calls (unfunded commitments) for ACERA's private equity funds. Because this cash is allocated to the liquid traditional asset managers and withdrawn primarily from the Mellon S&P 500 index, costs were estimated to be an additional 1.5 basis points per year or \$53,000, based on the unfunded commitments as of 9/30/2016. Verus concurred and staff added that, by policy, ACERA has a zero percent allocation to cash. Given the returns of the Mellon S&P 500 over the last 1 to 5 years, the returns far exceed the cost to invest the unfunded capital commitment.
- The Chair asked that future Quarterly Rebalancing Reports reflect and delineate cash flows within the Total Fund and amounts paid out of the Total Fund to meet month-end benefit payments. Specifically: 1) the dollar amounts to meet capital calls and new investments, 2) income distributions from existing investments, and 3) funds withdrawn and paid out of the



total fund to supplement monthly retirement benefits and meet month-end payroll and plan administrative costs.

- Trustee Gamble inquired about the delay in rolling out the various RFPs. Staff mentioned that RFPs require a lot of preparation to follow established procedures and it is not unusual for RFPs to take up to 9-months to complete. Verus concurred.
- Trustee Basgal noted that ACERA's Proxy Voting Consultant, Institutional Shareholder Services Inc. had voted against individual corporate directors or slates of directors numerous times and asked why such votes occurred. Staff offered that ISS follows the guidelines in the ACERA Proxy Voting Guidelines and Procedures in voting ACERA's shares; there were no exceptions noted in preparing the quarterly report.
- Trustee Basgal asked a question regarding the time involved to administer the Investment Products Services Introductions (IPSI) Program. Staff will respond at a future ICM.

FUTURE DISCUSSION ITEMS

None

ESTABLISHMENT OF NEXT MEETING DATE

April 12, 2017 at 9:30 a.m.

ADJOURNMENT

The meeting adjourned at 11:54 a.m.