



ALAMEDA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

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Date: May 18, 2016
To: Members of the Board of Retirement
From: George Wood–Chair
Subject: Summary of May 18, 2016 Investment Committee Meeting

The Investment Committee met on Wednesday, May 18, 2016 at 9:37 a.m. The Committee members present were Dale Amaral, Ophelia Basgal, Tarrell Gamble, Liz Koppenhaver, and George Wood. Also present was Alternate Safety member Darryl Walker. Members of the Staff present were David Nelsen – Chief Executive Officer, Kathy Foster – Asst. Chief Executive Officer, Margo Allen – Fiscal Services Officer, Joseph Fletcher – Chief Counsel, Harsh Jadhav – Chief of Internal Audit, and Betty Tse – Chief Investment Officer.

ACTION ITEMS

1. Discussion of and Possible Motion to Recommend to the Board to Adopt a New International Equity Manager Structure
 - Staff has concluded that there has been a lack of consistency in selecting performing managers, especially net of fees. To introduce more control and consistency, Staff concurs with Verus recommendation to move to a more passive approach, especially in the large cap international equities, which will provide more consistency with large cap international market performance net of fees.
 - Representatives from Verus presented and recommended to members of the Investment Committee an alternative Manager Structure for the International Equity asset class. With Staff's concurrence, Alternative 2 was recommended to the Committee, specifically (1) establish a 40% target to Core Non-U.S. Equity Index from 0% exposure (passive management); (2) increase Core Non-U.S. Equity (large cap quantitative) from 20% to 40%; and, (3) add a 10% allocation for a newly established Emerging Markets sub-asset class with a dedicated investment manager(s). This eliminates active Core Non-U.S. Equity growth and value styles.
 - The basis of the recommendation is to (1) reduce active risk (i.e., volatility), (2) minimize style drift risk, and (3) analyze for a more cost-effective solution for net performance.
 - A representative from ACERA's large cap Non-U.S. Equity growth manager (Capital Group) spoke on behalf of the firm's active management product and suggested a reduced asset management fee plus a performance-based fee as an alternative.
 - After discussion, Ms. Liz Koppenhaver moved, seconded by Mr. Dale Amaral, to recommend to the Board to adopt a new International Equity Manager Structure.
 - The motion was carried with 5 yes (Amaral, Basgal, Gamble, Koppenhaver, and Wood), 1 no (Walker), and 0 abstention.

2. Discussion of and Possible Motion to Recommend to the Board to Adopt an Amended ACERA Proxy Voting Guidelines and Procedures
 - Staff recommended updates to the ACERA Proxy Voting Guidelines (Guidelines) to reflect current proxy voting issues, aligning the Guidelines with the ISS Benchmark Proxy Voting Policy. Staff described enhancements to sections on corporate governance, election of directors, and capital structure.
 - After discussion, Ms. Ophelia Basgal moved, seconded by Ms. Liz Koppenhaver, to recommend to the Board to adopt an Amended ACERA Proxy Voting Guidelines and Procedures. The vote was unanimous.
 - The motion was carried with 6 yes (Amaral, Basgal, Gamble, Koppenhaver, Walker, and Wood), 0 no, and 0 abstention.
3. Discussion of and Possible Motion to Recommend to the Board to Reinvest proceeds from Property Sales by Jamestown Premier Property Fund
 - Representative from Callan and staff gave a brief explanation regarding Jamestown PPF's distribution of property sale proceeds and its requirements to reinvest such proceeds as a new investment. Hence Board approval is required. Staff also asked the Committee to approve the ongoing reinvestments of the future property sales proceeds.
 - After discussion, Mr. Dale Amaral moved, seconded by Ms. Liz Koppenhaver, to recommend to the Board to Reinvest Proceeds from Property Sales by Jamestown Premiere Property Fund. The vote was unanimous.
 - The motion was carried with 6 yes (Amaral, Basgal, Gamble, Koppenhaver, Walker, and Wood), 0 no, and 0 abstention.

INFORMATION ITEM

1. Review of Kennedy Capital Management (Traditional Manager – Small Cap Value)
 - The representative of Kennedy Capital management discussed the firm's history, ownership structure, investment team, the anticipated changes in the management of ACERA's portfolio, and the anticipated retirement of its President & CEO.
 - The representative also discussed the performance of the portfolio, its philosophy and strategy, the current market environment, the portfolio's positioning, and likely near-term changes in the portfolio's composition.
 - As of March 31, 2016, Kennedy's 1-year gross return of -8.04% underperformed its gross benchmark (Russell 2000 Value +250 bps) return of -5.38% by 266 basis points.

Kennedy's 3-year gross return of 9.84% outperformed its benchmark return of 8.37% by 147 basis points.

2. Review of Pzena Investment Management, LLC (Traditional Manager – Large Cap Value)

- Staff expressed disappointment over Pzena's poor performance, and reported that staff and Verus would be discussing different options about this investment style in the portfolio with the Committee.
- The representative from Pzena Investment Management, LLC discussed the firm's long-term, deep value investment philosophy, investment strategy, portfolio characteristics, and performance. The review found Pzena to be in compliance with ACERA's reporting requirements; however, staff noted the continuance of poor performance of the manager who remains on ACERA's Watchlist and Probation status.
- As of March 31, 2016, Pzena's 1-year gross return of -4.9% underperformed its benchmark (Russell 1000 Value +200 bps) return of 0.5% by 540 basis points. Pzena's 3-year gross return of 8.9% underperformed its benchmark return of 11.4% by 250 basis points.

Recommendations

- The Committee recommends, and I move, that the Board adopt a new International Equity Manager Structure. Specifically (1) establish a 40% target to Core Non-U.S. Equity Index from 0% exposure (passive management); (2) increase Core Non-U.S. Equity (large cap quantitative) from 20% to 40%; and, (3) add a 10% allocation for a newly established Emerging Markets sub-asset class with a dedicated investment manager(s). This eliminates active Core Non-U.S. Equity growth and value styles.
- The Committee recommends, and I move, that the Board Adopt an Amended ACERA Proxy Voting Guidelines and Procedures as provided by Staff.
- The Committee recommends, and I move, that the Board approve the Reinvestment of the proceeds from Property Sales by Jamestown Premiere Property Fund both currently and in the future.

TRUSTEE/PUBLIC INPUT

FUTURE DISCUSSION ITEMS

None

ESTABLISHMENT OF NEXT MEETING DATE

June 8, 2016 at 9:30 a.m.

ADJOURNMENT

The meeting adjourned at 12:07 p.m.