

September 14, 2011

To: Members of the Board of Retirement

From: Dale Amaral – Chair

Subject: Summary of the September 14, 2011 Investment Committee Meeting

The Investment Committee met on Wednesday, September 14, 2011 at 9:33 a.m. The Committee members present were Dale Amaral, Annette Cain-Darnes, Keith Carson, Liz Koppenhaver, Elizabeth Rogers, and George Wood. Also present were Alternate Safety members David Safer and Darryl Walker. Members of the Staff present were Vincent Brown – Chief Executive Officer, Kathy Foster – Assistant Chief Executive Officer, Robert Gaumer – Chief Counsel, J.P. Singh – Chief Financial Officer, Betty Tse – Chief Investment Officer.

ACTION ITEMS

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

1. Discussion of and Possible Motion to Recommend to the Board to Adopt ACERA's Real Returns Pool Policy
 - In April, 2011, the Board established revised asset allocation targets within which a new asset class, Real Return Pool, comprised 5% allocation target of the Total Fund. To establish a clear scope and objectives for and to guide and govern investing in Real Return Pool assets, Staff and Strategic Investment Solutions, Inc. (SIS) presented a proposed Real Return Pool Policy (Policy) designed to be an addendum to ACERA's General Investment Guidelines, Policies and Procedures. The proposed benchmark for the Real Return Pool asset class is the Core Consumer Price Index plus 300 basis points annualized. Investments in the Real Return Pool are alternative investments.
 - Staff and SIS responded to questions from the Committee concerning the types of assets to be used, if the investments will be "opportunistic," possible future changes in the Real Return Pool asset percentage, and the performance benchmark.
 - After discussion, Ms. Liz Koppenhaver moved, seconded by Ms. Elizabeth Rogers, to recommend to the Board to adopt ACERA's Real Return Pool Policy. The motion passed unanimously.
2. Discussion of and Possible Motion to Recommend to the Board to Adopt an Investment in Real Returns Pool – Commodities
 - A representative from Gresham Investment Management LLC (Gresham) provided an overview of the firm and the investment team and explained the diversification and liquidity benefits of commodity investments in institutional portfolios. Gresham also presented the investment process of its Enhanced Tangible Asset Program (ETAP) fund in detail.

- ETAP’s objective is to provide investors with a partial inflation hedge and an attractive risk/return profile through exposure to a diversified pool of liquid commodity futures. ETAP has a long history and has outperformed the TAP Fund, and the indices, S&P-GSCI and DJ-UBSCI. The primary difference between ETAP and the TAP Fund is that ETAP operates with “relaxed trading constraints” as compared to TAP.
 - After discussion, Ms. Annette Cain-Darnes moved, seconded by Ms. Elizabeth Rogers, to recommend to the Board to adopt a \$30.0 million investment in ETAP pending completion of legal due diligence and contract negotiation. The motion passed unanimously.
3. Review of ACERA’s Directed Brokerage Policy (DB Policy) and Possible Motion to Recommend to the Board to Adopt Amendments to the DB Policy
- Staff completed its third formal review of ACERA’s DB Policy since adoption and proposed amendments to the DB Policy to: 1) update Appendix I and Appendix II to the Policy; 2) recommend to the Board a new DB review cycle of at least every 3 years or as needed; 3) add one additional responsibility to the Third-Party DB Administrator; 4) make certain language changes to clarify terms or reflect the current practice of the DB Program, and specifically items in Appendix III, “Reporting Schedule.”
 - After discussion, Ms. Elizabeth Rogers moved, seconded by Ms. Liz Koppenhaver, to recommend to the Board to Adopt Amendments to the DB Policy. The motion passed, one opposed.
4. Review of ACERA’s Directed Brokerage Program and Possible Motion to Recommend to the Board to Continue the Program
- Staff presented its third comprehensive review of ACERA’s DB Program since inception through 2Q11 and concluded that ACERA achieved all four goals as set forth in the DB Policy. In addition, Staff provided the Committee with a cost-benefit analysis which showed a net gain of approximately \$605K (approximately \$135K annually) since inception through 2Q11.
 - A representative from Zeno Consulting Group, LLC, ACERA’s Transaction Cost Consultant, discussed the firm’s analysis on Best Execution practices of participating Investment Managers. Zeno expressed its satisfaction with ACERA’s DB Program and stated that Staff continues to perform extraordinary due diligence work on the Program when compared to its peers.
 - After discussion, Ms. Liz Koppenhaver moved, seconded by Mr. George Wood, to recommend to the Board to continue the DB Program. The motion passed unanimously.

Information Items:

1. Review of ACERA's Third-Party Directed Brokerage Administrator – Capital Institutional Services, Inc.
 - Staff conducted the third service review of ACERA's Third-Party DB Administrator – Capital Institutional Services, Inc. (CAPIS) and concluded that CAPIS fulfilled its roles and responsibilities as set forth in the DB Policy as well as its contractual obligations since inception with ACERA.
 - CAPIS described its organization, the current state of securities trading in general, SEC trade reporting requirements versus European reporting requirements, and the status of ACERA's commission recapture program. In line with Zeno Consulting Group, LLC, CAPIS recommends ACERA continue its DB Program.
2. Education and Update: Hedge Funds (Part III)
 - Continuing with the education sessions provided by SIS at the February and March 2011 Investment Committee Meetings, SIS presented a third education session and an update on Hedge Funds and, more specifically, Funds of Funds (FOHF's). SIS reviewed certain basic tenants of the funds, including their objectives, characteristics, pros, cons, challenges, and structures. In connection with its continuing recommendation to ACERA to make its first hedge fund investment an institutional quality FOHF, SIS has reduced its starting universe of 178 such funds contacted, evaluated, and visited in its due diligence process to 40 funds. SIS plans to recommend two or three finalists to ACERA at the October 12, 2011 Investment Committee Meeting.
3. Quarterly performance review for the second quarter of 2011 – equities and fixed income
 - ACERA's total Fund returned 1.0% in the second quarter of 2011 and was ranked in the upper 66th percentile among public funds greater than \$100.0 million. The Fund outperformed its Policy Index by 0.1% and underperformed the median public fund by 0.2%, respectively. Longer term, the three-year gross return of 5.0% (37th percentile) underperformed its Policy Index by 0.2% and the five-year gross return of 5.1% (36th percentile) underperformed its Policy Index by 0.7%. The market value of the total Fund as of 6/30/11 was \$5,449,874,936.00.
4. Quarterly performance review for the second quarter of 2011 – real estate
 - Townsend Group (Townsend) also discussed its sale of 70% equity ownership to Aligned Asset Managers LLC (Aligned) and the associated changes to Townsend's management structure. This transaction was meant to provide liquidity for Townsend's original founders, Terry Ahern and Kevin Lynch, as well as equity ownership to deserving Townsend personnel. Staff is continuing its examination and will report back to the Board relevant findings during the October Investment Committee Meeting. SIS will also conduct additional due diligence on this transaction for ACERA.

- ACERA's real estate portfolio returned 3.8% (net) in the second quarter of 2011, underperforming its benchmark ODCE (net) of 4.4% by 0.6%. Longer term, the three-year and five-year net returns of -9.1% and -1.8% underperformed the benchmark by 0.6% and 0.9%, respectively. As of 6/30/11, the total market value of ACERA's real estate portfolio was \$297,753,516.00.

5. Report on ACERA's rebalancing activities – August 2011

- ACERA completed three rebalancing transfers that were approved in August 2011 totaling approximately \$186.4 million. The objective of the rebalancing transfers was to capture profits from well-performing accounts (Baird Advisors, Brandywine Global, Loomis Sayles) and to capitalize on the return potential of relatively undervalued accounts (NCG Small Cap, NCG Ultra Cap, and Mellon Capital) through re-alignment towards the target allocation percentages of the asset classes and the investment managers.

RECOMMENDATIONS

- The Committee recommends, and I move that the Board adopt the ACERA's Real Returns Pool Policy.
- The Committee recommends, and I move that the Board adopt a \$30.0 million investment in Gresham's Enhanced Tangible Asset Program.
- The Committee recommends, and I move, that the Board adopt Amendments to the Directed Brokerage Policy.
- The Committee recommends, and I move, that ACERA's Directed Brokerage Program continue.

FUTURE DISCUSSION ITEMS

None

TRUSTEE/PUBLIC INPUT

ESTABLISHMENT OF NEXT MEETING DATE

October 12, 2011 at 9:00 a.m.

ADJOURNMENT

The meeting adjourned at 12:33 p.m.