

San Mateo County Employees' Retirement Association
Minutes of the Investment Committee

November 25, 2003 – Investment Committee Agenda

PUBLIC SESSION – The Committee met in Public Session at 10:00 A.M.

- 1.0 Call to Order
- 2.0 Roll Call
- 3.0 Approval of the Minutes for the Investment Committee Meeting
- 4.0 Oral Communications From the Committee
- 5.0 Oral Communications From the Public
- 6.0 Investment Management Services of the Investment Committee
 - 6.1 Acceptance of Monthly Portfolio Performance Report
 - 6.2 Acceptance of Quarterly Investment Performance Analysis for periods ending September 30th
 - * 6.3 Annual Investment Manager Review – Bank of Ireland Asset Management
 - 6.4 SamCERA's Investment Manager Structure – International Equity & Fixed Income
 - 6.5 Approval of Domestic Equity Manager Structure Implementation
 - 6.6 Approval of Renewal of Investment Management and Custody Agreement with Barclays Global Investors
 - 6.7 Approval of Report on Summary of Terms for INVESCO's Core Real Estate Fund.
- 7.0 Other Business
- 8.0 Adjournment

**The Committee will briefly discuss this topic. The Agenda Item in its entirety will be heard at the Board.*

MINUTES OF SAMCERA's Investment Committee

- 1.0 Call to Order:** Mr. Bryan called the Public Session of the Investment Committee of the Board of Retirement to order at 10:00 A.M November 25, 2003, in *SamCERA's* Board Room, Suite 125, 100 Marine Parkway, Redwood Shores, California.
- 2.0 Roll Call:** Mr. Bryan, Ms. Arnott for Mr. Buffington, Ms. Colson, and Mr. Lewis *Board Members in Attendance:* Ms. Salas, and Ms. Stuart *Staff:* Mr. Clifton and Mr. McCausland. *Consultant:* Ms. Jadallah, *Public:* none *Retirees:* One (10:50)
- 3.0 Approval of the Minutes:** The October 28, 2003 Investment Committee Minutes were unanimously approved.

Action: Motion by Ms. Colson, seconded by Mr. Lewis, carried unanimously to accept the Investment Committee Minutes.
- 4.0 Oral Communications From the Committee:** None
- 5.0 Oral Communications From the Public:** None
- 6.1 Acceptance of Monthly Portfolio Performance.** Mr. Clifton reported that domestic and international equities continued to perform well in October. The quarter ended October 31, 2003 saw all asset classes post positive returns. *SamCERA's* fiscal year to date total returns, 6.68%, trail the Plan Policy Benchmark, 7.53% by 85 basis points.

The end of October saw the Federal Reserve's Open Market Committee hold the federal funds rate at a 45 year
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low of 1.0%, while providing encouraging news about the labor market “stabilizing” rather than “weakening”. However, some segments of the market experienced great turmoil. The SEC announced that it is probing Strong and Putnam families of funds along with a number of firms for market timing and late trading. Institutional investors immediately began to pull monies from those managers. For anyone who has forgotten that there is more to emerging-market investing than picking cheap stocks, Russia offered a rude awakening. The Russia stock market experienced its worst showing since the '98 financial meltdown after Mikhail Khodorkovsky, head of oil giant Yukos, was arrested on fraud and tax evasion charges with prosecutors then freezing shares of Yukos. The dollar continued its slide, hitting a three year low against the yen and a five-year low against the British pound.

The table presented below shows the composite returns

October 31, 2003		One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	\$910,777,677	6.07%	7.77%	19.50%	23.99%
Equity Composite Benchmark		6.40%	8.91%	21.45%	27.30%
Variance		-0.33%	-1.14%	-1.95%	-3.31%
Fixed Income Aggregate	\$374,604,055	-0.84%	2.45%	0.85%	5.14%
Fixed Income Composite Benchmark		-0.93%	2.37%	0.57%	4.91%
Variance		0.09%	0.08%	0.28%	0.23%
Real Estate Aggregate (1)	\$58,063,037	0.33%	0.83%	4.20%	13.28%
NCREIF (one quarter lag)		0.00%	1.97%	4.10%	7.83%
Variance		0.33%	-1.14%	0.10%	5.45%
Cash Aggregate	\$15,632,564	0.12%	0.56%	1.24%	2.13%
91 Day Treasury Bill		0.08%	0.26%	0.56%	1.25%
Variance		0.04%	0.30%	0.68%	0.88%
Total Fund Returns	\$1,359,077,334	3.78%	5.89%	12.93%	17.67%
Total Plan Policy Benchmark		3.89%	6.62%	14.08%	19.55%
Variance		-0.11%	-0.73%	-1.15%	-1.88%

The table below shows portfolio market values and target weightings versus actual allocations.

Asset Allocation As of 10/31/2003	Market Value	Allocation Current	Allocation Target	Percentage Off Target	Rebalance Range
BGI Russell 1000	\$554,209,251	40.78%	40.00%	0.78%	±5%
BGI Russell 2000	\$158,080,625	11.63%	10.00%	1.63%	±5%
BIAM	\$198,487,802	14.60%	15.00%	-0.40%	±5%
Total Equity	\$910,777,677	67.01%	65.00%	2.01%	
BGI US Debt	\$207,609,528	15.28%	16.00%	-0.72%	±3%
DAMI	\$166,994,527	12.29%	13.00%	-0.71%	±3%
Total Fixed Income	\$374,604,055	27.56%	29.00%	-1.44%	
Real Estate	\$58,063,037	4.27%	6.00%	-1.73%	±2%
Cash	\$15,632,564	1.15%	0.00%	1.15%	
Total	\$1,359,077,334	100.00%	100.00%		

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Mr. Lewis requested periodic review of the components that constitute BGI's US Debt Index Fund. Performance reports and portfolio profiles for the seven components were distributed as a supplement to the performance report. Beginning with the quarter ending 12/31/2003, the Board will receive a quarterly performance report plus a portfolio profile report for the components.

Action: The Committee unanimously accepted the Monthly Performance Report. The Committee will recommend to the Board of Retirement that it accept the report.

6.2 Acceptance of Strategic Investment Solutions' Quarterly Investment Performance Analysis for the period ending September 30, 2003

Ms. Jadallah presented SIS' quarterly performance report. Below is selected summary detail from Strategic Investment Solutions' Quarterly performance Report.

Fund & Manager Performance Summary

- The composite fund returned 2.8% in the third quarter of 2003 and ranked 56th among other public funds greater than \$100 million (median of 3.0%). The fund trailed its policy index (3.5%) during this time period. Longer term, the three and five-year returns of -1.4% (73rd percentile) and 4.2% (78th percentile), respectively, were below median among large public plans (-0.5% and 5.1%).
- Third quarter results were enhanced by the following factors:
 1. The BGI Russell 1000 Index Fund ranked in the second quartile among large cap managers (median 2.8%), and matched its benchmark. The Russell 1000 Index had a return of 3.0%.
 2. The BGI Russell 2000 Index Fund matched its benchmark, the Russell 2000 Index (9.1%), and ranked above the small cap equity manager median of 7.8%.
 3. Deutsche Asset (0.0%) was ahead of the Lehman Aggregate Index and ranked 45th among other core bond managers. Deutsche Asset's significant overweight to the overall mortgage sector, and particularly to the utility stranded-assets and manufactured housing portions, were significant contributors to performance. The portfolio's lower exposure to lower quality investment grade corporate credits dampened performance. Deutsche Asset continues to carry a bias towards higher quality corporates.
- Third quarter results were hindered by the following factors:
 1. Bank of Ireland's quarterly return trailed its benchmark, the MSCI All Country World ex-US Free Index (4.4% vs. 8.7%), and the international equity managers' median of 8.0%. The portfolio lost relative value as low-quality highly valued stocks dominated the market rally. Relatively poor security selection in its pharmaceuticals (Aventis), oil (Shell Transport & Trading, Total), and telecom (Telecom Italia) holdings hurt the portfolio. Japanese stocks, such as Nippon Telegraph & Telephone and NTT DoCoMo, fared well.
 2. The BGI US Debt Index Fund (-0.2%) matched its index, the Lehman Aggregate, but not the median core bond manager (-0.1%). BGI ranked in the 64th percentile among its peers.
 3. INVESCO Realty returned 1.2% for the quarter, lagging the NCREIF Index (2.0%) and ranking in the third quartile among real estate investments. The Hunter's Creek property was sold off in September at a slight loss.

CAPITAL MARKET REVIEW: THIRD QUARTER 2003

ECONOMIC REVIEW

- During the 3rd quarter, the Fed met in August and September but did not change the target for the federal funds rate from 1.0%. The trade deficit through August was \$324.4 billion, 22.3% higher than the year-to-date total for

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the same period in 2002. Imports increased by 8.6% while exports grew by 3.0%. In the third quarter, the U.S. dollar weakened 9.1% against the yen (109.82), and 2.3% against the euro (\$1.1772). Industrial production advanced in July (+0.8% rev.), slipped in August (-0.1% rev.), and improved in September (+0.4%). Nonetheless, industrial production was 0.6% lower than its September, 2002 level. After rising 6.8% in the second quarter, productivity rose 8.1% in the third quarter as labor costs fell 4.6% in the period.

- After expanding at an annualized rate of 3.3% in the second quarter, in the third quarter GDP expanded again at an annualized rate of 7.2%. In September, the consumer price index was 2.3% higher year-over-year. Core CPI, excluding food and energy, was 1.2% higher than it was a year ago. Unemployment was 6.1% in September, down marginally from 6.4% in June. Retail sales rose 1.4% in July and 1.2% in August but fell -0.2% in September.

EQUITY MARKETS REVIEW

- U.S. stocks continued to rebound with the DJIA, NASDAQ, and the S&P 500 rising 3.8%, 10.1%, and 2.6%, respectively. All but three economic sectors had positive returns in the third quarter. The best-performing sector was information technology (+10.8%). Within this sector, the best-performing sub-industries were electronic manufacturing services (+28.7%), semiconductors (+25.6%), and home entertainment software (+24.7%). The next-best-performing sector was materials (+6.3%). The strongest sub-industries were diversified metals and mining (+29.5%) and gold (+20.6%). Communications, Healthcare and Utilities all ended the quarter down, declining -9.3%, -4.7% and -0.5% respectively.
- During the quarter, growth and value stocks showed positive results. The Russell 1000 (large cap), Russell Mid Cap, and Russell 2000 (small cap) indices were up 3.0%, 6.4%, 9.1% respectively. Growth stocks outperformed value stocks and small caps outperformed large caps.
- Global equity markets enjoyed another positive quarter as the weight of economic data pointed toward healthy growth in the second half of 2003. A rise in industrial output, improving demand and higher confidence levels prompted a surge in share prices of companies particularly geared to an economic upturn. The MSCI World Index advanced 4.9% in dollar terms while the MSCI EAFE Index gained 8.2%. The Japanese market, as measured by the MSCI Japan Index climbed 22%, in anticipation that its export-oriented economy would be among the main beneficiaries of the improving environment. Elsewhere in the Pacific region, the MSCI Hong Kong Index surged 26% as the government increased its economic growth forecasts for 2003. European markets were among the weaker performers, with the MSCI Europe ex-UK index gaining 5%, led mainly by a rebound in beaten down technology stocks and cyclicals.

FIXED INCOME MARKETS REVIEW

- Following both third quarter meetings, the FOMC indicated that the upside and downside risks to sustainable growth are roughly equal but that the probability of an unwelcome fall in inflation, "though minor," exceeds that of a rise in inflation. The Committee expressed the belief that "policy accommodation can be maintained for a considerable period." The market was disappointed by the FOMC's failure to reduce the fed funds rate. The yield curve shifted upward and the short-to-intermediate sector steepened in the third quarter. The two-year Treasury yield rose 17 basis points to 1.5%, while the 10-year yield rose 43 basis points to 3.9%. The 30-year Treasury bond yield rose 32 basis points to 4.9% over the course of the quarter.
- The Lehman Aggregate Bond Index posted a 0.1% loss and the Citigroup World Government Bond Index gained 2.0% for the quarter. High yield corporates, as measured by the Lehman U.S. High Yield Index, rose 2.8%. Emerging Markets Debt, as measured by the J.P. Morgan Emerging Markets Bond Index rose 2.4%. Although mortgage backed securities were quite volatile over the quarter, the Lehman Mortgage Backed Index ended the quarter only 0.5% higher.

REAL ESTATE MARKETS REVIEW

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- For the nine months ending September 30, 2003, the NAREIT Index returned 24.7%, continuing to outperform many of the public indices. For the third quarter of 2003 alone, the REIT market return 9.5%, as investors continued to search for yield.
- Among the different property sectors, the big winner was lodging with a return of 19.3%; other returns include self storage with 14.5%, regional malls, 12.6%, office 5.3%, and manufactured homes, 5.8%. If the economy continues to recover, lodging, industrial and apartments may either start or continue to participate.

The table below compares the Composite Fund Portfolio and Manager Portfolios to their Benchmarks. It also shows how the portfolios rank in their peer universe as of September 30, 2003.

	Last Quarter		Fiscal Year-To-Date		Last Year	
	Return	Rank	Return	Rank	Return	Rank
Composite Fund	2.79%	56	18.06%	39	-1.43%	73
<i>Policy Index</i>	<i>3.50%</i>	<i>30</i>	<i>20.04%</i>	<i>21</i>	<i>-2.07%</i>	<i>83</i>
BGI Russell 1000 Fund	3.00%	46	25.14%	30	-10.30%	69
<i>Russell 1000 index</i>	<i>3.00%</i>	<i>46</i>	<i>25.14%</i>	<i>30</i>	<i>-10.33%</i>	<i>69</i>
BGI Russell 2000 Fund	9.10%	34	35.95%	31	-0.83%	62
<i>Russell 2000 index</i>	<i>9.08%</i>	<i>35</i>	<i>36.50%</i>	<i>28</i>	<i>-0.83%</i>	<i>61</i>
BIAM	4.42%	95	19.27%	87	-8.98%	76
<i>MSCI ACWI-ex US Index Free</i>	<i>8.68%</i>	<i>45</i>	<i>29.04%</i>	<i>30</i>	<i>-7.46%</i>	<i>54</i>
BGI US Debt Index Fund	-0.16%	64	5.56%	61	9.08%	47
Deutsche Asset Management	-0.01%	45	5.06%	76	9.61%	26
<i>Lehman Aggregate Index</i>	<i>-0.15%</i>	<i>63</i>	<i>5.41%</i>	<i>67</i>	<i>8.95%</i>	<i>56</i>
INVESCO	1.16%	67	13.60%	21	9.10%	29
<i>NCREIF Index</i>	<i>1.97%</i>	<i>56</i>	<i>7.83%</i>	<i>55</i>	<i>7.87%</i>	<i>41</i>
Cash Composite	0.64%	8	2.18%	13	3.47%	19
<i>91 Day T-Bill Index</i>	<i>0.25%</i>	<i>40</i>	<i>1.32%</i>	<i>41</i>	<i>2.91%</i>	<i>50</i>

The Committee asked Ms. Jadallah to provide greater detail on BIAM's under performance relative to its ACWI Free ex US Benchmark. She offered that recent underperformance may be attributed to their underweight Japan, overweight the UK; lack of emerging market exposure; and overweight Large Cap. The Committee was unanimous in its opinion that BIAM's is positioned to continue to lag the benchmark.

Action: The Committee unanimously accepted the Strategic Investment Solutions' Quarterly Performance Report. The report in its entirety will be presented to the Board at its afternoon meeting.

6.3 Annual Investment Manager Review – Bank of Ireland Asset Management

The Committee discussed BIAM's under performance relative to the ACWI Free ex US. ♦ On 11/26/2003 Mr. Bryan, Mr. Clifton and Ms. Jadallah met with two senior investment professionals from Bank of Ireland Asset Management. ♦ Ms. Jadallah reported, "in our meeting, Chris Reilly and Leona Nicholson described well how they have been through a particularly difficult market environment given their investment approach. (BIAM's third quarter return was 4.42% versus the MSCI ACWI-ex US Free Index return of 8.68%, and its one-year return was 19.27% versus the index return of 29.04%.) SIS

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agrees and applauds BIAM for being true to its discipline. BIAM's near-term outlook implies that the approach will be experiencing more "headwinds". The potential for further performance disappointments due to regional and scarcity of top line growth factors worry SIS. Lastly, as stated above, the fact that the International Equity portfolio is a suboptimal fit for an MSCI ACWI-ex US benchmark concerns us as well."

The Investment Committee was unanimous in its opinion that Bank of Ireland Asset Management should be placed on SamCERA's Watch List due to underperformance. As a Board, the trustees will discuss performance and inclusion on the Watch List with BIAM at the afternoon meeting.

Action: No action is required.

6.4 SamCERA's Investment Manager Structure – International Equity & Fixed Income. Strategic Investment Solutions' representative, **Margaret Jadallah**, presented Investment Manager Structure – International Equity & Fixed Income.

This introductory presentation flows from the Board's decision on 7/22/2003 to maintain the current asset allocation of 65% Equities (40% Domestic Large Capitalization, 10% Domestic Small Capitalization, and 15% International), 29% Fixed Income and 6% Real Estate and to review the current manager structure.

The goal of this presentation is to add Alpha to the International Equity and Fixed Income Structures while retaining Solid Managers

The international equity presentation contains four alternative structures for international equities:

- 1) Hire Bank of Ireland Asset Management (BIAM) Complement. (Active Risk 3.07%, Information Ratio 0.48, Alpha 1.50%)
- 2) Hire Core Manager. (Active Risk 5.00%, Information Ratio 0.30, Alpha 1.50%)
- 3) Hire Two Complementary Core Managers. (Active Risk 2.68%, Information Ratio 0.44, Alpha 1.20%)
- 4) Hire Two Complementary Style Managers. (Active Risk 3.83%, Information Ratio 0.55, Alpha 2.10%)

After discussing the alternative structures the Committee asked SIS to present three additional alternatives at the January 2004 meeting. Those alternatives were to include data from actual managers so that the Board may better view the relationship. The alternatives are outlined below:

- 1) One Core Manager (Growth Bias). (Active Risk 4.00%, Information Ratio 0.29, Alpha 1.20%)
- 2) Two Core Managers. (Active Risk 3.76%, Information Ratio 0.31, Alpha 1.20%)
- 3) One Core Value and One Core Growth Manager. (Active Risk 3.02%, Information Ratio 0.45, Alpha 1.35%)

The fixed income presentation contains five alternative structures for fixed income:

- 1) ½ Passive, ¼ Core, ¼ Core Plus. (Active Risk 0.43%, Information Ratio 0.54, Alpha 0.25%)
- 2) 1/3 Passive and 2/3 Core. (Active Risk 0.53%, Information Ratio 0.48, Alpha 0.27%)
- 3) 1/3 Passive, 1/3 Core, 1/3 Core Plus. (Active Risk 0.57%, Information Ratio 0.54, Alpha 0.33%)
- 4) ½ Passive and ½ Core. (Active Risk 0.75%, Information Ratio 0.37, Alpha 0.30%)
- 5) ½ Passive and ½ Core Plus. (Active Risk 0.85%, Information Ratio 0.54, Alpha 0.50%)

After a brief discussion the Committee opined to recommend to the Board that it adopt alternative three.

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Action: By consensus the Committee will recommend to the Board that SIS be instructed to return with three additional alternatives for the international equity manager structure. Also by Consensus the Committee will also recommend that the Board adopt a fixed income structure of 1/3 Passive, 1/3 Core, 1/3 Core Plus. (Active Risk 0.57%, Information Ratio 0.54, Alpha 0.33%).

- 6.5 Approval of Domestic Equity Manager Structure Implementation.** At the October Board meeting, staff was directed to contact BGI and inquire about availability of their Enhanced Small Cap Product. BGI reports that the product is currently closed with a number of potential investors in an unofficial queue. ♦ Ms. Jadallah reports that SamCERA may find many of the small cap products closed to new business. ♦ The Committee noted that the Board approved the domestic equity structure at the October meeting. In light of the challenges to find a small cap manager, the Committee will recommend to the Board that SIS present semi-finalist for the Large Cap Enhanced, Small Cap Enhanced, Small Cap Value and Small Cap Growth managers at the January 27, 2004 meeting. ♦ SIS was directed to use their database for the search versus issuing a Request for Proposal. SIS was further directed to report to the Board on the process used and the screens employed.

Action: Motion by Mr. Lewis, second by Ms. Colson, to recommend to the Board of Retirement that the Association begin implementation of the domestic manager structure.

- 6.6 Approval of Renewal of Investment Management and Custody Agreement with Barclays Global Investors, N.A.** The Board first employed Barclays Global Investors (BGI), then known as Wells Fargo Institutional Trust Company, on February 12, 1995 as a passive manager of Indexed Funds. In 1998 the Board and BGI renewed the Agreement for a second three-year period. On January 31, 2001 the Agreement was renewed for a third time. BGI manages ~\$919.9 million for SamCERA in three index products, the Russell 1000 Index Fund, Russell 2000 Index Fund and US Debt Index Fund. Marginal pricing applies to the calculation of the investment management fee, which is approximately 3.40 basis points per annum.

The attached Agreement is similar to SamCERA's standard contractual format. It is dissimilar from SamCERA's other Investment Management Agreements in that it addresses both the management and the custody of those Plan Assets allocated to BGI. Although the base format of the Agreement is BGI's, it embraces the concerns addressed with SamCERA's format. It is basically the same Agreement that was reviewed and approved by the Board in 1995, 1998, and 2001. The only amendment to this iteration of the Agreement appears in Paragraph Twelve.

12. Notwithstanding any other provision of this Agreement, the Manager shall not be liable for any loss to the Account caused directly or indirectly by government restrictions, exchange or market rulings, securities or suspensions of trading or, acts of civil or military authority, national emergencies, labor difficulties, fires, earthquakes, floods or other catastrophes, acts of God, wars, acts of terrorism, riots or failures of communication or power supply or by any other cause or causes beyond the Manager's reasonable control or anticipation, unless the Manager has breached its fiduciary duties in placement of the funds.

Paragraph Twenty-two is new. BGI wishes to codify certain disclosures of material facts and obtain the Board's consent pursuant to applicable law.

22. To the extent that SamCERA is not subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), the Manager is making disclosure of material facts and obtaining the Boards' consent pursuant to applicable law for the Manager to engage in the following activities, including through

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any common trust fund or collective investment fund in which SamCERA participates:

- (a) To trade through an affiliated broker-dealer;
- (b) To lend securities to one or more borrowers (each a "Borrower"), and to be compensated therefore; to lend securities through a common electronic platform in which the Manager has an equity interest; and to lend securities to a Borrower that is an affiliate of Manager;
- (c) To the extent provided for in the Guidelines, to purchase and sell shares of registered, open-end management investment companies, including exchange-traded funds and mutual funds, managed by an affiliate of the Manager;
- (d) To buy and sell securities in the Manager's cross-trading program, including as part of any transition services performed for the Plan; and
- (e) To buy, hold and sell shares of common stock of an affiliate of the Manager.

The Committee had no revisions of its own and approved BGI's requested amendments.

Action: Motion by Ms. Colson, second by Mr. Lewis, to recommend to the Board of Retirement that it approve the Barclays Global Investors' Contract as amended.

- 6.7 Approval of Report on Summary of Terms for INVESCO's Core Real Estate Fund.** As an alternative to the *SamCERA's* separate property strategy, the Board is considering an open-end commingled core fund to increase portfolio diversity. SamCERA's current Real Estate Investment Manager, INVESCO Realty Advisors, is developing an Open-End Core Commingled Fund, which will begin soliciting business in the first quarter of 2004. *SamCERA*, as a founding investor, has the option of obtaining shares for cash or by contributing assets. INVESCO developed a Fund Summary and a Summary of Terms that will be incorporated into the Plan Documents. SamCERA and Strategic Investment Solutions have been afforded an opportunity to review and suggest amendments to the Summary of Terms.

Action: No Action is required.

- 7.0 Other Business: None**

- 8.0 Adjournment:** There being no further business Mr. Bryan adjourned the Committee at 11:20 A.M.