

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

**January 24 2005– Investment Committee Agenda**

**PUBLIC SESSION** – The Committee met in Public Session at 10:05 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 Strategic Investment Solutions Report on Capital Market Assumptions
  - 6.3 Approval of Amendment Number One to INVESCO LLC Agreement
  - 6.4 Approval of Futures Agreement – Goldman Sachs Asset Management
- 7.0 Other Business
- 8.0 Investment & Finance Manager's Report
- 9.0 Adjournment

**MINUTES OF SAMCERA's Investment Committee**

- 1.0 Call to Order:** Mr. Lewis called the Public Session of the Investment Committee of the Board of Retirement to order at 10:05 a.m. January 24, 2005, in a Franklin Templeton meeting room in Building 920 at One Franklin Parkway San Mateo.
- 2.0 Roll Call:** Mr. Bryan, Mr. Lewis, Ms. Salas (excused), and Ms. Tashman. *Board Members in Attendance:* Ms. Stuart (10:30 a. m.) *Alternate Board Member:* None. *Staff:* Mr. Bailey and Mr. Clifton. *Consultant:* Strategic Investment Solutions - Ms. Jadallah and Mr. Thomas & Public Pension Professionals – Ira Summer. *Public:* none. *Retirees:* none.
- 3.0 Approval of the Minutes:** The members of the Investment Committee approved the minutes of September 28, 2004, October 25, 2004, and November 23, 2004.  
  
**Action: The Investment Committee approved the minutes of September 28, 2004, October 25, 2004, and November 23, 2004.**
- 4.0 Oral Communications From the Committee:** None
- 5.0 Oral Communications From the Public:** Ms. Jadallah, *SamCERA's* Investment Consultant, informed the Committee that subsequent to the departure of Peter Landers Barclays Global Investors is restructuring a portion of its organization. BGI will combine its Client Services and Client Relationship Groups. This type of reorganization is typical for BGI and should not greatly impact *SamCERA*.
- 6.1 Acceptance of Monthly Portfolio Performance.** Mr. Clifton presented the monthly performance for the period ending December 31, 2004. He noted the performance report's slightly different format due to the inclusion of the Association's new active managers. He reported *SamCERA's* Total Fund Return, 3.06% for December 2004 outperformed the Total Plan Policy Benchmark return of 2.86% by 20 basis points. The Fund's Fiscal Year to Date return, 8.43%, is 451 basis points ahead of the Actuarial Discount Rate of 3.92%. Ms. Tashman noted that assets had exceeded \$1.6 billion for the first time in the Association's history.

As they worked through the report, the trustees suggested enhancements to the new format. Those suggestions will be implemented in future reports. Mr. Lewis noted that when the committee begins work on amending the

*Investment Plan* we should address the rebalancing ranges that appear on page seven of the report. The table presented below shows the composite returns

December 31, 2004		One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	\$1,087,264,120	4.16%	12.29%	10.33%	15.43%
Equity Composite Benchmark		3.67%	11.75%	10.28%	14.75%
<b>Variance</b>		<b>0.49%</b>	<b>0.54%</b>	<b>0.05%</b>	<b>0.68%</b>
Fixed Income Aggregate	\$457,005,408	0.94%	1.00%	4.32%	4.88%
Fixed Income Composite Benchmark		0.92%	0.95%	4.18%	4.34%
<b>Variance</b>		<b>0.02%</b>	<b>0.05%</b>	<b>0.14%</b>	<b>0.54%</b>
Real Estate Aggregate (1)	\$54,967,034	5.07%	5.07%	12.20%	18.04%
NCREIF (one quarter lag)		4.90%	4.41%	8.27%	14.52%
<b>Variance</b>		<b>0.17%</b>	<b>0.66%</b>	<b>3.93%</b>	<b>3.52%</b>
Cash Aggregate	\$4,986,409	0.23%	0.61%	1.18%	2.35%
91 Day Treasury Bill		0.21%	0.48%	0.85%	1.33%
<b>Variance</b>		<b>0.02%</b>	<b>0.13%</b>	<b>0.33%</b>	<b>1.02%</b>
Total Fund Returns	\$1,604,222,970	3.06%	8.38%	8.43%	11.67%
Total Plan Policy Benchmark		2.86%	8.06%	8.37%	11.65%
<b>Variance</b>		<b>0.20%</b>	<b>0.32%</b>	<b>0.06%</b>	<b>0.02%</b>

Performance versus SamCERA's Actuarial Discount Rate

Total Fund Returns		3.06%	8.38%	8.43%	11.67%
Actuarial Discount Rate		0.64%	1.94%	3.92%	8.00%
<b>Variance</b>		<b>2.42%</b>	<b>6.44%</b>	<b>4.51%</b>	<b>3.67%</b>

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

Asset Allocation As of 012/31/2004	Market Value	Allocation Current	Target	Percentage Off Target	Rebalance Range
Barclays Global Investors R1 Alpha Tilts	\$327,589,243	20.42%		20.00%	0.42%
Barclays Global Investors Russell 1000	\$313,343,667	19.53%		20.00%	-0.47%
Brandes Investment Partners	\$48,509,471	3.02%		2.50%	0.52%
Chartwell Investment Partners	\$47,173,182	2.94%		2.50%	0.44%
Goldman Sachs Asset Management	\$93,650,930	5.84%		5.00%	0.84%
Barclays Global Investors Russell 2000	\$8,157	0.00%		0.00%	0.00%
Julius Baer Investment Management	\$129,316,134	8.06%		7.50%	0.56%
Mondrian Investment Partners	\$127,673,337	7.96%		7.50%	0.46%
Total Equity	\$1,087,264,120	67.78%		65.00%	2.78%
Barclays Global Investors US Debt	\$152,142,420	9.48%		9.66%	-0.18%
Deutsche Asset Management, Inc.	\$159,230,353	9.93%		9.67%	0.26%
Western Asset Management Company	\$145,632,635	9.08%		9.67%	-0.59%
Total Fixed Income	\$457,005,408	28.49%		29.00%	-0.51%
INVESCO Realty Advisors	\$54,967,034	3.43%		6.00%	-2.57%
Cash	\$4,986,409	0.31%		0.00%	0.31%
Total	\$1,604,222,970	100.00%		100.00%	

Mr. Clifton noted a discrepancy in the Julius Baer returns versus the Custodian's calculated returns due to the timing of a corporate action (News Corporation). He went on to explain *SamCERA's* process for reconciling Investment Manager to Custodian reports. The committee briefly discussed the fact that transitioning from a primarily passive portfolio to one with increased active management necessitates a substantially different workflow for staff. Finally, the committee noted the monthly report has a great deal of information, including periods longer than one month. The trustees reiterated that short periods are not the appropriate measure of a manager's performance. Although, the short term plays into the associations monitoring practices, longer trends are more valuable. Perhaps the monthly report could focus more on the trailing three and twelve-month returns.

Quarterly, the committee receives a supplementary report that illustrates the components of the BGI US Debt Fund. This report was originally requested by Mr. Lewis. He stated, and the committee agreed, that the report is no longer required.

Mr. Bailey inquired into the method that the committee uses to approve action items. He noted that because the Committee makes recommendations to the board. The board may find it useful to be able to hear or read the committee's motion and vote. After a brief discussion the committee by consensus agreed to seek a motion, second and vote on all action items brought before it.

**Action: Motion by Bryan, second by Tashman, carried unanimously, to accept the monthly performance report and recommend that the Board of Retirement accept the report.**

**6.2 Acceptance of Strategic Investment Solutions Report on Capital Market Assumptions.** Strategic Investment Solutions' Margaret Jadallah and Patrick Thomas presented their report on Capital Market Conditions and *SamCERA's* Portfolio Asset Allocation. Public Pension Professionals' IRA Summer was present to discuss differences between an investment consultant's assumption and those of an actuary.

Mr. Thomas described the asset mix optimization process. He reminded the committee that Strategic Investment Solutions is somewhat contrarian, while it believes in reversion to the mean. The three inputs for optimization in order of importance are i) Return (geometric annual growth rate), ii) Risk (standard deviation around expectation), and iii) Correlation (degree to which assets move together). These inputs should be used to help with strategic thinking and not to get caught up in market timing. The CAPM projections should be for a period covering two to three market cycles, which may vary over time: but is considered to be ten to twenty years. The output from the optimization is the efficient frontier (the lowest level of risk per unit of return or highest available return per unit of risk).

The Investment Committee and SIS worked through the capital market expectation methodology illustrated in the following table.

**Capital Markets Expectation Methodology**

<b>Asset Class</b>	<b>Derivation</b>
Inflation	Consensus of Economists' Forecasts, TIPS
Cash	Inflation + 1 to 2% Premium
US Large Cap	CAPM, 3 to 6% Equity Premium, Macroeconomic DDM
US Fixed	Yield to Worst on Aggregate (Compare to Historic Bond Risk Premium, Adjust if Necessary).
US Small Cap	CAPM, (Beta of ~1.2)
Private Markets	CAPM, (Beta of ~1.6)
International Equity	Weighted Sum of Local Market Equity Premium + Local Risk-Free Rate

International Bond	US Fixed Return, Adjusted for Quality and Duration (Potential currency effects based on PPP)
Real Estate	Historical Behavior of Equity REITs, Current Appraisal Cap Rate, CAPM
High Yield	Historical Ratio: Spread of High Yield over US Fixed Income ÷ Spread of Large Cap over US Fixed Income

The above methodology was employed to determine the inflation and capital markets projections summarized in the table that follows:

### Capital Market Expectations

CATEGORY	EXPECTED RETURN	EXPECTED RISK	SHARP RATIO
U.S. Large Cap Stocks	8.4%	15.7%	0.312
U.S. Small Cap Stocks	9.2%	22.0%	0.259
U.S. Fixed Income	4.6%	5.0%	0.220
Intl Developed Markets Stocks	8.9%	19.4%	0.278
Intl Emerging Market Stocks	9.9%	32.0%	0.200
Intl Fixed Income	4.6%	9.5%	0.116
Private Markets	11.4%	35.0%	0.226
Real Estate	6.8%	14.0%	0.229
High Yield	5.7%	8.0%	0.275
Emerging Market Debt	6.5%	13.5%	0.222
Cash	3.5%	1.3%	0.000

### Correlations

	US LARGE CAP	US SMALL CAP	US FIXED INCOME	INTL DEV MKT	EMERG MKT	INTL FIXED INCOME	PRIVATE MKTS	REAL ESTATE	US HIGH YIELD	EMERG MKT DEBT	
U.S. Large Cap Stocks	1.00										
U.S. Small Cap Stocks	0.78	1.00									
U.S. Fixed Income	0.19	0.19	1.00								
Intl Developed Markets Stocks	0.75	0.65	0.17	1.00							
Intl Emerging Market Stocks	0.65	0.62	0.17	0.65	1.00						
Intl Fixed Income	0.10	0.08	0.40	0.33	0.10	1.00					
Private Markets	0.60	0.68	0.10	0.56	0.57	0.10	1.00				
Real Estate	0.50	0.53	0.40	0.45	0.40	0.24	0.45	1.00			
High Yield	0.56	0.62	0.46	0.49	0.40	0.40	0.60	0.40	1.00		
Emerging Market Debt	0.53	0.50	0.31	0.48	0.65	0.40	0.57	0.40	0.45	1.00	

The table below shows unconstrained pre-tax optimization results using SIS projections. Inserted into that table are the previous and projected expectations from *SamCERA's* Asset Allocation.

	Mix 1	Mix 2	<b>SamCERA Expected</b>	SamCERA Previous	Mix 3	Mix 4	
U.S. Large Cap Stocks	20.2%	22.4%	<b>40.0%</b>	40.0%	25.7%	27.2%	
U.S. Small Cap Stocks	2.4%	3.9%	<b>10.0%</b>	10.0%	5.0%	6.4%	
U.S. Fixed Income	48.0%	41.7%	<b>29.0%</b>	29.0%	29.5%	24.6%	
Intl Developed Markets Stocks	13.4%	16.8%	<b>15.0%</b>	15.0%	18.6%	22.4%	
Intl Emerging Market Stocks	0.1%	0.8%	<b>0.0%</b>	0.0%	2.0%	3.3%	
Intl Fixed Income	2.5%	1.6%	<b>0.0%</b>	0.0%	4.0%	0.7%	
Private Markets	2.0%	4.1%	<b>0.0%</b>	0.0%	5.7%	3.1%	
Real Estate	4.1%	5.7%	<b>6.0%</b>	6.0%	7.4%	9.8%	
High Yield	4.1%	0.1%	<b>0.0%</b>	0.0%	0.2%	0.0%	
Emerging Market Debt	3.1%	2.9%	<b>0.0%</b>	0.0%	1.8%	2.5%	
% Equities	42.3%	53.6%	<b>71.0%</b>	71.0%	64.4%	72.2%	
Total Pre-Tax Return	7.04%	7.58%	<b>7.81%</b>	8.23%	8.11%	8.64%	
Total Pre-Tax Risk	8.74%	10.33%	<b>11.56%</b>	11.74%	12.08%	13.94%	

In response to a question from Mr. Bryan, Mr. Thomas stated that the significant disparity of 42 basis points between SIS' previous and current expectations for *SamCERA's* projected portfolio in the report was mainly due to the length of time since those earlier expectations were made (18 months to date).

The Committee discussed the actuarial assumption rate, 8.0%, as it relates to *SamCERA's* expected return, 7.81%. They opined that erring on the conservative side probably benefits the association and the plan sponsor. Mr. Summer reminded the Committee the nominal assumption rate is approximately 7.85%, which with semi-annual compounding equates to 8.0%.

The committee agreed that the assumption rate for the 2005-2006 fiscal year is set at 8.0%. However, they wished to be proactive in establishing a "conservative" rate for fiscal year 2006-2007. The trustees agreed that timely CAPM projections from the investment consultant will aid in the consideration of the appropriate rate. Strategic Investment solutions revisits the CAPM projections semi-annually. *SamCERA* will receive those projections in November and May. The May projections should be timely for consideration when establishing assumptions for the actuary to incorporate in the June 30 Actuarial Valuation.

Mr. Bryan noted that the Board of Supervisors (BOS) is considering issuance of a Pension Obligation Bond. The trustees discussed the association's funding ratio, assumption rate, and possibility of exceeding the assumption rate. These should all be considerations for the BOS when they determine the amount of bond to float.

**Action: Motion by Bryan, second by Tashman, carried unanimously, to accept the monthly**

performance report and recommend that the Board of Retirement accept the report.

- 6.3 Approval of Amendment Number One to INVESCO LLC Agreement.** The Investment Committee discussed the origin of the proposed amendment, which was a request made by SamCERA prior to transitioning assets to the INVESCO Core Real Estate – U.S.A. Fund in September 2004. At that time the Board expressed a concern regarding the possible departure of INVESCO senior partners and the Association’s ability to exit the Fund under those circumstances. When approached by staff, INVESCO provided an attestation letter divulging the existence of two-year employment contracts between INVESCO Institutional (N.A.) or its affiliates and the six INVESCO Real Estate Global Partners – David Ridley, David Farmer, Max Swango, Paul Michaels, Scott Dennis and Joe Rodriguez. Further to the attestation, INVESCO provided a side letter to all “Founding Investors”, which states, “The Manager will promptly, and in no event later than sixty (60) days after the date of the Initial Closing, present to the Members for their vote an amendment to the Operating Agreement (pursuant to Section 17.6 thereof) providing that the Lock-Out Expiration Date shall occur upon the earlier of: (a) the date when the Net Asset Value of the Fund reaches \$500 million and (b) the date upon which three (3) or more of the following individuals, who are Global Partners, are no longer employed by and associated with INVESCO Institutional (N.A.), Inc. and its Affiliates: David Ridley, David Farmer, Paul Michaels, Joe Rodriguez, Scott Dennis and Max Swango.”

On November 30, 2004, SamCERA received a consent document and Amendment Number One to the Core Fund’s Operating Agreement. The essence of the amendment is that the definition of “Lock-out Expiration Date” shall be revised as follows (with bold underlined text being added), effective as of the initial closing.

“Lock-Out Expiration Date” means **the earlier of:** (a) the date when the Net Asset Value of the Fund reaches \$500 million **and (b) the date upon which three (3) or more of the following individuals, who are Global Partners, are no longer employed by and associated with INVESCO Institutional (N.A.), Inc. and its and its Affiliates: David Ridley, David Farmer, Paul Michaels, Joe Rodriguez, Scott Dennis and Max Swango.**

The procedure for amending the Amended and Restated Limited Liability Company Agreement of INVESCO Core Real Estate – U.S.A., LLC (a Delaware limited liability company) is stated under Article 17 – Miscellaneous Provisions, 17.6 Amendments . . . “this Agreement may be amended by the Manager only with the consent of a majority of the Voting Power; . . .”

As of this meeting, the amendment had been approved by a 59% of the outstanding shares of INVESCO Core Real Estate – U.S.A, LLC. Since approval requires consent of 50% of the voting interest, the amendment had been incorporated into the LLC. Although SamCERA’s acceptance of the amendment was not required, staff recommended that the Board authorize the Chair to execute the consent document so SamCERA may be on record as in support of the amendment.

The proposed Resolution follows:

SAN MATEO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION  
**Amendment Number One**  
**to the Amended and Restated**  
**Limited Liability Company Agreement**  
**of INVESCO Core Real Estate – U.S.A., LLC**  
RESOLUTION 04-05-21

**WHEREAS**, Article XVI, §17 of the Constitution of the State of California vests the Board with *"plenary authority and fiduciary responsibility for the investment of moneys and the administration of the system"*; and

**WHEREAS**, Government Code §31595 vests in the Board “. . . *exclusive control of the investment of the*

*employees retirement fund.” and*

**WHEREAS**, Government Code §31596.1 (d) authorizes the Board to retain investment managers “. . . *in connection with administration of the Board's investment program . . .*”; and

**WHEREAS**, The Board of Retirement opined that an open-end commingled fund real estate mandate would allow *SamCERA* to achieve the diversity of property type, geographical location and range of market values that the Plan could not achieve with its separate property mandate; and

**WHEREAS**, Board Resolution 04-05-09 delegates full discretionary authority to the INVESCO Core Real Estate – U.S.A., LLC Fund to manage the assets of the Retirement Fund as allocated by the Board in accordance with the terms of the Amended and Restated Limited Liability Company Agreement (the “Operating Agreement”) of INVESCO Core Real Estate – U.S.A., LLC.; and

**WHEREAS**, The Board expressed concern regarding the possible departure of INVESCO senior partners and wished assurances that the Association could exit the fund under those circumstances.; and

**WHEREAS**, INVESCO proposed Amendment Number One to the Operating Agreement revising the definition of “Lock-out Expiration Date” as follows (with bold underlined text being added), effective as of the initial closing. “Lock-Out Expiration Date” means **the earlier of:** (a) the date when the Net Asset Value of the Fund reaches \$500 million **and (b) the date upon which three (3) or more of the following individuals, who are Global Partners, are no longer employed by and associated with INVESCO Institutional (N.A.), Inc. and its and its Affiliates: David Ridley, David Farmer, Paul Michaels, Joe Rodriguez, Scott Dennis and Max Swango.**; and

**WHEREAS**, the Board wishes to consent to Amendment Number One to the Amended and restated Limited Liability Company Agreement of the Fund dated as of September 30, 2004 (the “operating Agreement”). Therefore, be it

**RESOLVED** that the Board hereby authorizes the Board Chair to execute Amendment Number One to the INVESCO Core Real Estate – U.S.A., LLC Fund Subscription Documents.

The committee noted that the amendment had been incorporated into the INVESCO Core Real Estate – U.S.A., LLC Fund Subscription Documents and that board approval would reaffirm its desire that the “Lock-Out Expiration Date” be amended to include the departure of key persons.

**Action:** Motion by Bryan, second by Tashman, carried unanimously, to recommend that the Board of Retirement adopt Resolution 04-05-21, which authorizes the Chair to execute Amendment Number One to the INVESCO Core Real Estate – U.S.A., LLC Fund Subscription Documents.

- 6.4 Approval of Futures Agreement – Goldman Sachs Asset Management.** On October 26 2004, the Board executed an Investment Management Agreement with Goldman Sachs Asset Management (GSAM). In Exhibit C, Equity Investment Objectives, Guidelines, Restrictions and Fee Agreement, investment in certain types of securities are specifically permitted. The Agreement states, “When deemed appropriate by the Investment Manager, the Investment Manager may invest a portion of the Assets in futures contracts for the purpose of acting as a temporary substitute for investment in common stocks. GSAM will not engage in speculative futures transactions.” Goldman Sachs Asset Management requested the ability to use futures to equitize the cash in *SamCERA*’s portfolio.

Mr. Lewis noted that *SamCERA* equitizes cash in the BGI Index Funds. The association is not required to execute a separate futures agreement with BGI. Why is it required with GSAM? Mr. Clifton explained that

SamCERA owns units in the BGI Funds, not the actual assets, while at GSAM, SamCERA is the beneficial owner of the assets. Ownership of the assets drives the decision regarding in whose name the futures agreement is executed. Ms. Jadallah stated that SIS inquired with other enhanced index managers. Those managers also require a separate futures agreement for their separate account clients.

The committee then considered: 1) *SamCERA's Investment Plan* states, "The Board Shall . . . Delegate to its Investment Managers full discretionary investment authority consistent with the provisions of the Investment Plan and the individual investment manager contracts." 2) Goldman Sachs Asset Management's (GSAM) mandate from *SamCERA* is to be fully invested in the equity market. 3) Goldman Sachs Asset Management wishes to use futures as a tool to equitize the cash in *SamCERA's* portfolio so that it may remain fully invested. 4) That removal of the drag on cash should incrementally improve returns, but more importantly reduce portfolio risk.

In response to a question from Mr. Lewis, Mr. Clifton stated that he and Ms. Carlson had reviewed the proposed futures agreement. The committee discussed the fact that futures agreements are new to SamCERA and due to their complexity perhaps the association should seek the opinion of an outside expert. The committee turned to SIS who stated that the review documentation is a little outside of what they do; but as a business policy of equitizing frictional cash, they believe that is the correct thing to do. It was determined that an efficient method of reviewing the documentation would be to request one of SamCERA's Investment Manager to review the document.

**Action: The Investment Committee, without objection, agreed to the execution of the Goldman Sachs Futures Agreement, permitting the equitization of cash. The committee, however, would like to forward the agreement to Western Asset Management for review by its compliance department to ensure that the documentation is industry standard. Action on this agenda item will be postponed to a later board meeting following the results of further documentation review.**

**7.0 Other Business: None**

**8.0 Investment & Finance Managers Report:**

**9.0 Adjournment:** There being no further business Mr. Lewis adjourned the committee at 11:20 A.M.