

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

May 22, 2006 – Investment Committee Agenda

PUBLIC SESSION – The committee met in Public Session at 10 a.m.

- 1.0 Call to Order
- 2.0 Roll Call
- 3.0 Approval of the Minutes
- 4.0 Oral Communications From the Committee
- 5.0 Oral Communications From the Public
- 6.0 Investment Management Services - the Investment Committee Shall Review & Discuss
 - 6.1 Monthly Portfolio Performance Report
 - 6.2 Quarterly Investment Performance Analysis for Period Ended March 31, 2006
 - 6.3 * Annual Review of SamCERA's Fixed Income Asset Class and Investment Managers
 - 6.3 a Annual Investment Manager Review – Fidelity Management Trust Company
(Interviewed By The Investment Committee on May 22nd)
 - 6.3 b Annual Investment Manager Review – Western Asset Management
(Interviewed By The Investment Committee on May 22nd)
 - 6.3 c Annual Investment Manager Review – Aberdeen Asset Management
(Interviewed By The Board)
 - 6.4 Introduction to a Review of SamCERA's Investment Management Agreement (IMA)
 - 6.5 Approval to Implement Security Lending
 - 6.6 Approval of Topics for the Investment Consultant Review – Strategic Investment Solutions
 - 6.7 Approval to Execute Documentation with Pyramis Group Trust (Fidelity Management Trust Company)
 - 6.8 Report on the Strategic Investment Solutions' Capital Market Outlook
- 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:** Ms. Colson called the Public Session of the Investment Committee of the Board of Retirement to order at 2 p.m. May 22, 2006, in SamCERA's Board Room, Suite 125, 100 Marine Parkway, Redwood Shores, California.
- 2.0 Roll Call:** Mr. Bryan, Ms. Colson, Mr. Hackleman and Ms. Tashman. *Other Board Members in Attendance:* Ms. Stuart. *Alternate Board Member:* None. *Staff:* Mr. Bailey, Mr. Clifton and Ms. Dames. *Consultants:* Mr. Thomas of Strategic Investment Solutions. *Public:* None. *Retirees:* None.
- 3.0 Approval of the Minutes: Motion** by Bryan, second by Hackleman, carried unanimously to approve the investment committee minutes of April 25, 2006, as submitted.
- 4.0 Oral Communications From the Committee:** None.
- 5.0 Oral Communications From the Public:** None.
- 6.1 Monthly Portfolio Performance Report:** Mr. Clifton presented the Preliminary Monthly Performance Report for the period ending April 30, 2006. SamCERA's 1.71% Total Fund Return for April 2006

substantially outperformed the Total Plan Policy Benchmark return of 1.20%. The Fund's Fiscal Year to Date (FYTD) return, 13.02%, is 640 basis points above the FYTD Actuarial Discount Rate, 6.62%, and 64 basis points above *SamCERA's* Total Plan Policy Benchmark of 12.38%.

In testimony to the Joint Economic Committee, Federal Reserve Chairman Bernanke stated that "at some point in the future the committee may decide to take no action ... in the interest of allowing more time to receive information relevant to the outlook." However, most participants believe continuing economic strength will keep the Fed in the picture. Even if the FOMC pauses, they may need to tighten further later in the year to slow economic growth to a sustainable pace.

Mr. Clifton brought to the committee's attention BGI's outstanding performance in alpha tilts which outperformed the benchmark by nearly 400 basis points over a trailing 12-month period. He noted that this remarkable return should be considered unusual and that trustees should not expect such returns in the future. Mr. Clifton also reported that *SamCERA's* small cap managers have had a good month and that Brandes achieved a notable 3.67% return compared to the Russell 2000 return of -0.02%.

He also said that Julius Baer Investment Management has done a very good job for the association. Mr. Clifton withdrew \$10 million from Julius Baer for operational purposes. Another \$10 million will be taken from the BGI Russell 1000 for operational needs before June 30th. He reminded the board that the County will be transferring their employer contribution pre-payment to *SamCERA* in the first week of July, which will be approximately \$51 million.

The table presented below shows the composite returns.

March 31, 2006	Market Value	One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	\$1,205,792,096	1.97%	7.07%	9.75%	18.35%
Equity Composite Benchmark		2.29%	7.14%	9.83%	18.54%
Variance		-0.32%	-0.07%	-0.08%	-0.19%
Fixed Income Aggregate	\$493,495,462	-0.62%	-0.14%	0.54%	3.25%
Fixed Income Composite		-0.98%	-0.65%	-0.06%	2.26%
Variance		0.36%	0.51%	0.60%	0.99%
Real Estate Aggregate (2)	\$110,629,327	5.49%	5.49%	8.32%	21.06%
NCREIF (one quarter lag)		4.44%	4.44%	10.11%	15.00%
Variance		1.05%	1.05%	-1.79%	6.06%
Cash Aggregate	\$2,619,388	0.28%	0.93%	1.76%	3.34%
91 Day Treasury Bill		0.39%	1.02%	1.95%	3.53%
Variance		-0.11%	-0.09%	-0.19%	-0.19%
Total Fund Returns	\$1,812,536,273	1.36%	4.80%	6.88%	13.66%
Total Plan Policy Benchmark		1.47%	4.70%	6.95%	13.86%
Variance		-0.11%	0.10%	-0.07%	-0.20%
Performance versus Actuarial Discount Rate					
Total Fund Returns		1.36%	4.80%	6.88%	13.66%
Actuarial Discount Rate		0.64%	1.94%	3.92%	8.00%
Variance		0.72%	2.86%	2.96%	5.66%

Action: No action is required. The Monthly Portfolio Performance Report is an informational report.

6.2 Quarterly Investment Performance Analysis for Period Ended March 31, 2006

Mr. Thomas reviewed the investment performance for the first quarter. He noted that the negative dispersion between *SamCERA's* GSAM separate account and the composite has improved. *SamCERA's* separate account outperformed the composite by 40 basis points (12.5% vs. 12.1%). He stated that it was a good quarter overall for the plan.

The investment committee recommended changes to SIS' report for next quarter. The Russell 1000 benchmark will be added to the small cap manager comparison regardless of style and style benchmarks will be added to the international manager comparison.

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 March 31, 2006.

	Last Quarter		One Year		Last 3 Years	
	Return	Rank	Return	Rank	Return	Rank
<i>Composite Fund</i>	4.80%	43	13.66%	51	16.59%	42
<i>Policy Index</i>	4.65%	53	13.81%	50	16.81%	38
BGI Russell 1000 Alpha Tilts	4.98%	34	15.89%	28	N/A	N/A
BGI Russell 1000 Index Fund	4.51%	43	13.24%	57	18.34%	59
<i>Large Cap Composite</i>	4.75%	37	14.58%	45	19.26%	48
<i>Russell 1000 Index</i>	4.49%	44	13.20%	57	18.30%	59
Brandes Investment Partners	4.88%	99	6.56%	100	N/A	N/A
Chartwell Investment Partners	14.76%	19	26.65%	37	N/A	N/A
Goldman Sachs Asset Management	12.51%	44	22.73%	58	N/A	N/A
<i>Small Cap Composite</i>	11.20%	62	19.55%	80	28.10%	58
<i>Russell 2000 Index</i>	13.94%	27	25.85%	42	29.53%	43
<i>U.S. Equity Composite</i>	6.02%	47	15.61%	53	21.00%	56
Julius Baer Asset Management	12.36%	10	31.97%	17	N/A	N/A
Mondrian Investment Partners	8.47%	65	22.90%	69	N/A	N/A
<i>International Equity Composite</i>	10.46%	26	27.44%	46	29.95%	73
<i>MSCI ACWI-ex US Index Free</i>	9.76%	42	28.13%	42	33.51%	27
<i>Total Equity Composite</i>	7.07%		18.35%		23.04%	
Aberdeen Asset Management	-0.42%	49	2.72%	43	3.91%	29
Fidelity Management Trust Co.	N/A	N/A	N/A	N/A	N/A	N/A
Western Asset Management	-0.17%	18	3.60%	6	N/A	N/A
<i>U.S. Fixed Income Composite</i>	-0.46%	73	2.91%	46	3.59%	51
<i>Lehman Aggregate Index</i>	-0.65%	86	2.26%	84	2.92%	71
INVESCO Core Fund	5.49%	27	21.07%	37	N/A	N/A
<i>Real Estate Composite</i>	5.49%	27	21.06%	37	17.03%	29
<i>NCREIF Index</i>	3.62%	55	20.19%	43	15.07%	43
<i>Cash Composite</i>	0.93%	74	3.34%	70	2.84%	13
<i>91 Day T-Bill Index</i>	1.02%	54	3.53%	52	2.09%	47

Action: The quarterly investment performance report is informational. No action is required.

6.3 Annual Review of SamCERA's Fixed Income Asset Class and Investment Managers

6.3 a Annual Investment Manager Review – Fidelity Management Trust Company *(Interviewed By The Investment Committee on May 22nd)*

Art Greenwood, Senior Vice President, Sales, **Dan Tremblay**, Vice President, Fixed Income Investment Director, and **Chris Pariseault**, Investment Director, were present for Fidelity Management Trust Company's annual review.

Mr. Greenwood discussed the establishment of Pyramis Global Advisors as a separate subsidiary of Fidelity in order to heighten the focus on institutional asset management and make a clear distinction from Fidelity's mutual fund business. Pyramis is in the process of converting its clients' contractual relationships from Fidelity Management Trust Company to Pyramis Global Advisors as a separate Fidelity business unit. Mr. Greenwood stated that the process should be largely transparent. There have been no changes to SamCERA's investment management team nor resources.

In response to a question from Mr. Thomas, Mr. Greenwood would like to complete some initiatives in the domestic equity space prospectively by developing its resources to serve institutional clients better with customized reporting and a higher degree of transparency.

In response to a question from Ms. Tashman, Mr. Greenwood is unaware of any changes in employee compensation packages. He noted that the Fidelity ownership structure has remained unchanged with this internal demarcation from Fidelity to Pyramis. Mr. Tremblay said that there was no interest in forming a completely separate business from Fidelity.

Mr. Tremblay then reviewed the quarter ending March 31, 2006. In February and March 2006, the initial two months, the portfolio earned 11 bps. He noted that an additional 16 bps was earned to date, with a total of 27 bps added to the portfolio. He attributed the gain to the overweight to spread sectors, increased exposure to credit, overweight position in CMBS and ABS. An underweight to MBS pass-throughs and overweight to hybrid MBS which trailed fixed rate MBS hurt the portfolio slightly.

He then reviewed the rating and sector allocation in the broad market duration portfolio which includes 66.9% in AAA bonds and is well diversified in credit allocation.

In response to a question from Mr. Clifton, Mr. Greenwood indicated that there is no update regarding the Wells Notice but will keep *SamCERA* informed of any changes.

Ms. Colson then took up agenda item 6.7.

6.3 b Annual Investment Manager Review – Western Asset Management *(Interviewed By The Investment Committee on May 22nd)*

Andre Cuerington, Client Service Executive, and **Donald Plotsky**, Product Specialist, were present for Western Asset Management's annual review.

Mr. Cuerington discussed Western's acquisition of Citigroup Asset Management. He stated that the transition has gone smoothly. The acquisition has added to Western's global growth, now with offices in Sao Paulo, Melbourne, Tokyo and New York. Western brought over approximately 300 Citi employees with the bulk in the New York office. They have also merged some staff in its London and

Singapore offices.

He then highlighted market sector returns and a broad market outlook. He stated that the market will incur moderate growth at 3.0 +/- GDP, with inflation rising moderately and Fed tightening (5.0% year-end Fed funds rate). The SamCERA's portfolio has performed well, outperforming the benchmark over several time periods attributable to sector and credit quality allocation.

In response to a question from Mr. Thomas, Mr. Cuerington indicated that Peter Wilby, one of CitiGroup's notable portfolio managers, started his own investment firm starting April 1st. His firm will primarily focus on emerging markets and high yield.

Mr. Plotsky then reviewed Western's absolute return strategy which attempts to maximize return independent of what occurs in the marketplace. The expected return over a 3 to 5 year time-period is 2 or more bps over the broad market and 2 to 4 bps over LIBOR. He indicated that the absolute return product that SamCERA would be interested in commenced in mid-2004 and currently has \$2.7 billion. Management fees would be approximately 40 bps. A separate account would require a \$200 million minimum commitment with no minimum for the commingled fund since SamCERA is already a client. He also noted that the first fund to join the product was a public fund, Tennessee Valley Authority (TVA).

Ms. Colson then took up agenda item 6.6.

6.3 c Annual Investment Manager Review – Aberdeen Asset Management
(Interviewed By The Board)

Aberdeen Asset Management was interviewed by the full board at the board meeting.

6.4 Introduction to a Review of SamCERA's Investment Management Agreement (IMA)

Mr. Clifton introduced a draft of a suggested boilerplate IMA. Ms. Carlson will review the IMA paragraph by paragraph in July.

Action: No action was taken. The review of SamCERA's Investment Management Agreement will continue at the July committee meeting. The full board will be asked to provide comments regarding possible inclusions or deletions to the agreement.

6.5 Approval to Implement Security Lending

Mr. Thomas stated that SIS has a neutral stance on securities lending. He stated that SamCERA certainly needs to look at the risk of the securities lending program. He said that SIS is comfortable with the risk-averse guidelines set forth in the most conservative pool, Navigator Plus. He also stated that State Street is a respectable vendor and that the 70% / 30% is a good split.

Mr. Clifton stated that he and Ms. Jadallah discussed with State Street their Quality-D pool, the second to most conservative pool. He opined that the guidelines of this pool were too broad. It is the recommendation of staff and SIS is to go with the most conservative fund. State Street has also agreed to the 70% / 30% split. The move from the Quality-D pool to the Navigator Plus pool will reduce SamCERA's initial estimated income provided by State Street by approximately \$50,000. The estimated revenue will now be approximately \$450,000 – \$500,000 per year.

Action: Motion by Hackleman, second by Bryan, carried unanimously to recommend that the association approve the implementation of the securities lending program to the full board.

Ms. Colson then took up agenda item 6.3b.

6.6 Approval of Topics for the Investment Consultant Review – Strategic Investment Solutions

Mr. Clifton requested that committee members complete and return the investment consultant performance evaluation form to him as soon as possible.

Action: Motion by Tashman, second by Byran, carried unanimously to recommend the approval of topics for Strategic Investment Solutions' Investment Consultant Review.

Ms. Colson then took up agenda item 6.8.

6.7 Approval to Execute Documentation with Pyramis Group Trust (Fidelity Management Trust Company)

Mr. Clifton briefly discussed the Pyramis Global Advisors documentation that will allow *SamCERA* plan assets to be transferred from Fidelity Group Trust to a corresponding pool in the Pyramis Group Trust. Ms. Carlson has also reviewed the documentation. Nothing extraordinary was found in the documentation.

Action : Motion by Bryan, second by Hackleman, to recommend that the board approve execution of the documentation with Pyramis Group Trust.

Ms. Colson then took up agenda item 6.4.

6.8 Report on the Strategic Investment Solutions' Capital Market Outlook

Mr. Thomas reviewed his firm's Capital Market Outlook. The outlook allows SamCERA to semi-annually view the expectations for capital market returns. There has been virtually no change since the last report. Expected return increased slightly from 7.9% to 8.0% with a minor decrease in expected risk from 11.5% to 10.8%. SIS will provide an educational workshop on private equity sometime in the fall.

Action: SIS' Capital Market Outlook report is informational. No action is required.

7.0 Other Business: None

8.0 Investment & Finance Manager's Report: Mr. Clifton stated that INVESCO's quarterly report is now available.

9.0 Adjournment: There being no further business, Ms. Colson adjourned the committee at 4:25 p.m.