

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

**March 26, 2007 – Investment Committee Agenda**

**PUBLIC SESSION –**

- 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 Manager Structure Equity Modeling for Equities
    - 6.2a Approval of Manager Structure for U.S. Equity Modeling
    - 6.2b Introduction and Approval of Manager Structure International Equity Modeling
  - 6.3 Approval of Topics for Manager Review – Aberdeen Asset Management
  - 6.4 Approval of Topics for Manager Review – Pyramis Global Advisors
  - 6.5 Approval of Topics for Manager Review – Western 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. Hackleman called the Public Session of the Investment Committee of the Board of Retirement to order at 2 p.m. March 26, 2007, 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:* None. *Staff:* Mr. Bailey, Mr. Clifton and Ms. Dames. *Consultants:* Ms. Jadallah, Strategic Investment Solutions. *Public:* None. *Retirees:* None.
- 3.0 **Approval of the Minutes: Motion** by Bryan, second by Tashman, carried unanimously to approve the minutes of the February 27, 2007, Investment Committee minutes, as submitted.
- 4.0 **Oral Communications From the Committee:** Mr. Hackleman noted that he will not be able to attend the next month's Investment Committee meeting.
- 5.0 **Oral Communications From the Public:** None.
- 6.1 **Monthly Portfolio Performance Report:** Mr. Clifton presented the monthly portfolio performance report for the period ending February 28, 2007. *SamCERA's* -0.53% Total Fund Return for February 2007 underperformed the Total Plan Policy Benchmark of -0.23%. The Fund's return for the trailing twelve months is 12.02%, which is 427 basis points above the Actuarial Discount Rate of 7.75% and 45 basis points above *SamCERA's* Total Plan Policy Benchmark of 11.57%.

Interest rates fell last month as economic news suggested the economy was not as strong as many had thought. Concerns about the sub-prime mortgage market and a China-led flight to quality raised concerns about future growth prospects. The Chinese government taking measures to control the pace of stock

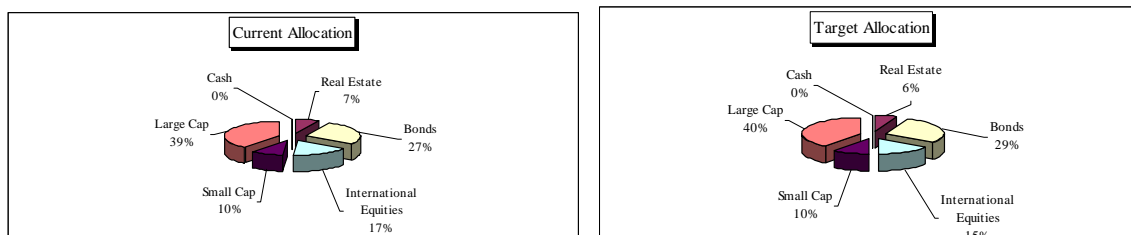
market gains, coupled with sluggish economic news out of the United States, also provided impetus for profit taking in the developed and emerging equity markets in the final days of February. The table presented below shows the composite returns.

February 28, 2007	Market Value	One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	\$1,342,555,812	-1.46%	2.09%	10.72%	14.05%
Equity Composite Benchmark		-1.04%	2.04%	10.49%	13.77%
<b>Variance</b>		<b>-0.42%</b>	<b>0.05%</b>	<b>0.23%</b>	<b>0.28%</b>
Fixed Income Aggregate	\$560,755,185	1.64%	1.05%	3.99%	6.19%
Fixed Income Composite		1.54%	0.91%	3.66%	5.54%
<b>Variance</b>		<b>0.10%</b>	<b>0.14%</b>	<b>0.33%</b>	<b>0.65%</b>
Real Estate Aggregate (2)	\$145,481,597	0.00%	3.32%	5.84%	19.24%
NCREIF (one quarter lag)		0.00%	4.51%	8.18%	16.59%
<b>Variance</b>		<b>0.00%</b>	<b>-1.19%</b>	<b>-2.34%</b>	<b>2.65%</b>
Cash Aggregate	(\$2,673,471)	0.38%	1.21%	2.27%	4.41%
91 Day Treasury Bill		0.38%	1.24%	2.52%	5.01%
<b>Variance</b>		<b>0.00%</b>	<b>-0.03%</b>	<b>-0.25%</b>	<b>-0.60%</b>
Total Fund Returns	\$2,046,119,123	-0.53%	1.89%	8.44%	12.02%
Total Plan Policy Benchmark		-0.23%	1.87%	8.36%	11.57%
<b>Variance</b>		<b>-0.30%</b>	<b>0.02%</b>	<b>0.08%</b>	<b>0.45%</b>

Performance versus Actuarial Discount Rate					
Total Fund Returns		-0.53%	1.89%	8.44%	12.02%
Actuarial Discount Rate		0.62%	1.88%	3.80%	7.83%
<b>Variance</b>		<b>-1.15%</b>	<b>0.01%</b>	<b>4.64%</b>	<b>4.19%</b>

*SamCERA's* current asset allocation is summarized as follows:



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

Mr. Hackleman then took up agenda item 6.3.

## 6.2 Manager Structure Equity Modeling for Equities

- 6.2a **Approval of Manager Structure for U.S. Equity Modeling** – Margaret Jadallah of Strategic Investment Solutions presented an additional five alternative portfolios for *SamCERA's* large cap equity manager structure, which was reviewed at the February 2007 Investment Committee meeting.

Also during that meeting, the Investment Committee had opined that no changes should be made to the small cap equity structure. Ms. Jadallah reviewed the guiding principles in manager structure analysis and the various manager attributes modeled in the U.S. equity study. She then noted that *SamCERA*'s current U.S. equity portfolio has a very minimal amount of style risk since most of the U.S. equity structure is implemented with index neutral characteristics. The low active risk of 1.07% and reasonable alpha of 0.60% make the structure quite conservative at this time. Ms. Jadallah then reviewed the five alternative portfolios in detail. The following large cap alternatives maintain *SamCERA*'s current small cap structure:

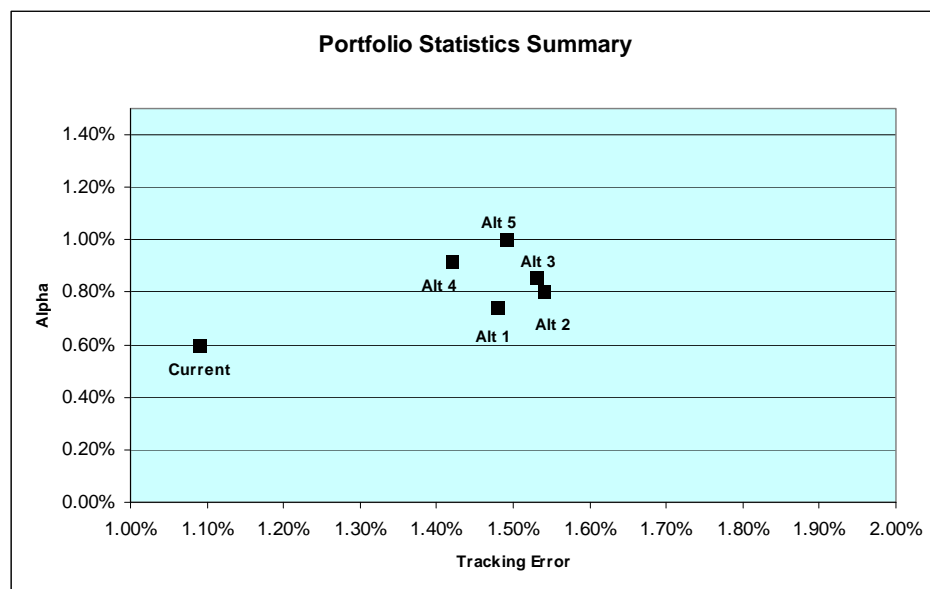
Alternative 1: 80% BGI Alpha Tilts, 20% BGI Russell 1000 Index

Alternative 2: 75% BGI Alpha Tilts, 20% BGI Russell 1000 Index, 5% BGI 120/20

Alternative 3: 70% BGI Alpha Tilts, 20% BGI Russell 1000 Index, 10% BGI 120/20

Alternative 4: 50% BGI Alpha Tilts, 20% BGI Russell 1000 Index, 12.5% Active Value, 12.5% Active Growth, 5% BGI 120/20

Alternative 5: 40% BGI Alpha Tilts, 20% BGI Russell 1000 Index, 15% Active Value, 15% Active Growth, 10% BGI 12/20



With Alternative 1, Ms. Jadallah stated that the style risk of 0.16% is still very low. The structure increases the risk to benchmark from 1.09% to 1.48%, however is still at the lower end of the risk spectrum of SIS' clients. In response to a question from Mr. Hackleman, Ms. Jadallah said that most clients are around the 2% risk level.

With Alternative 2, Ms. Jadallah listed the pros and cons of the 120/20 strategy. The 120/20 strategy is a much newer strategy which a few of SIS' clients are looking into seriously, two of which are conducting manager searches. On the positive side, it increases the breadth of a manager's skill set especially with stocks with small positions within the index. Studies show that the information ratio and the efficiency of the portfolio seem to increase slightly and that a good amount of return can result in good shorts. Studies also show that 20-30% of loosening the constraints is where the maximum effect is achieved. Negatively, the 120/20 strategy permits unlimited loss in short losses. SIS is looking mostly at managers that are enhanced index quantitatively driven who tend to have a better systematic way to prevent large losses in shorts. Ms. Jadallah stated that SIS knows of fifteen firms in this strategy which is a relatively small universe; however, more firms will undoubtedly open up products in this strategy with increased demand. The 120/20 product has a different fee structure that makes the fees a little uncertain. With BGI, it is a 35 bps base fee with a 20% of alpha incentive

fee. Ms. Jadallah said that the implementation does not impact *SamCERA*'s current structure very much, with no increase to style risk, adding a slightly increased amount of active risk while adding some small additional alpha.

Alternative 3 would give a higher allocation to the 120/20 strategy relative to alternative 2 (10% vs. 5%). It would give a slightly higher expected alpha and information ratio but not remarkably different from alternative 2. In response to a question from Mr. Bryan, Mr. Clifton stated that *SamCERA* would perform the normal RFP process should the board decide to implement a 120/20 strategy and that it would not automatically go to BGI, although BGI's product was modeled in the study. It was merely used as a proxy of a typical 120/20 quantitative product.

Alternative 4 adds active growth and value managers to the large cap structure. Adding active style would add diversification and provide more alpha. Style risk would increase slightly but would not impact the amount of total risk. Ms. Jadallah then reviewed the quartile rankings of the large cap growth and value universe. The fee structure would be 50 bps or less with active managers.

Alternative 5 gives a higher allocation to active growth, active value and the 120/20 strategy while decreasing the allocation from BGI alpha tilts. This structure slightly increases style risk to 0.31% but still relatively low and adds some additional alpha. It is the highest risk/reward alternative with an expected alpha of 1.00%. The structure's manager event risk is also the highest out of the five alternatives.

Ms. Jadallah noted that all five alternatives are very similarly situated in the risk/reward spectrum.

Pursuant to the committee's request, Ms. Jadallah then discussed the international equity manager structure modeling in agenda item 6.2b. Following the discussion and unanimous recommendation to keep *SamCERA*'s current international equity structure, the Investment Committee then revisited this U.S. large cap equity topic.

Ms. Colson voiced some concern over the newness and the fee structure (incentive fee) of the 120/20 strategy. Ms. Jadallah attested to the fact that tracking records for these products are also very short, many with one-year or less. Ms. Colson opined that it is difficult to find a very good active manager in the large cap space. Ms. Tashman noted that with 37% of total assets in large cap, active management in this asset class will increase fees considerably. A passive structure offers a clean, low-cost, easy-to-maintain simple program. Alternative 1 which will merely shift the weightings between *SamCERA*'s BGI Alpha Tilts and Russell 1000 Index portfolios will be relatively easier to implement while providing low costs relative to the other alternatives. The committee opined that the increased allocation to international equity from 15% to 21% will provide a good amount of risk and alpha to *SamCERA*'s total portfolio and that acquiring an additional large cap manager is unnecessary at this time.

**Motion** by Bryan, second by Colson, carried with 3 ayes and 1 no to recommend to the board to select Alternative 1 as *SamCERA*'s large cap equity manager structure.

Mr. Hackleman then took up agenda item 7.0.

- 6.2b **Introduction and Approval of Manager Structure International Equity Modeling** – Ms. Jadallah introduced the international equity manager structure modeling. She indicated that she was very comfortable with *SamCERA*'s current international equity structure. *SamCERA*'s structure consists of two managers with complimentary styles: Mondrian (core value) and Julius Baer (core growth), a good structural fit to the benchmark and a respectable amount of exposure to emerging markets.

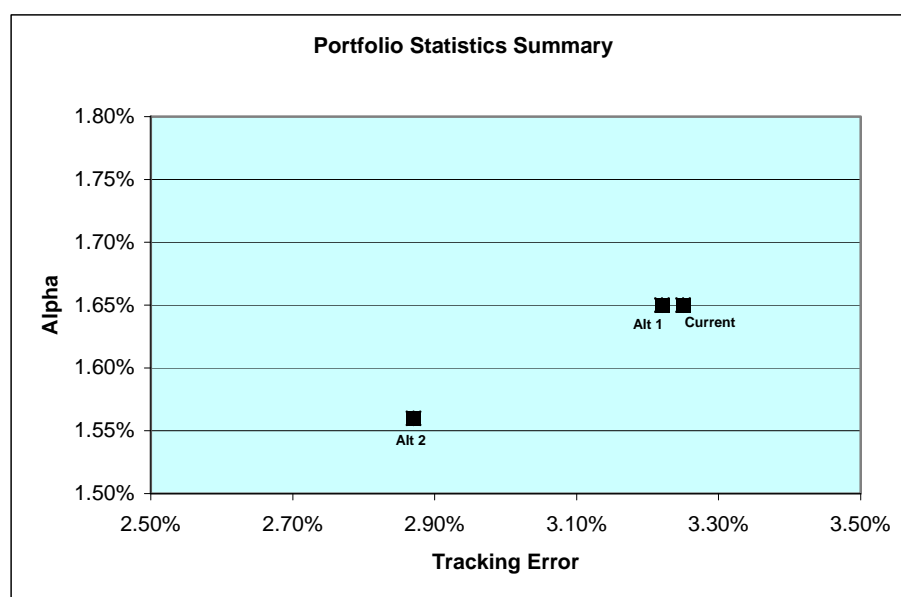
Ms. Jadallah reviewed the manager attributes modeled in the international equity manager structure. In addition to *SamCERA*'s current two managers, SIS modeled a quantitative manager that is style neutral with moderate tracking error and that takes stock selection decisions with a broad benchmark construct. In response to a question from Ms. Colson regarding international small cap, Ms. Jadallah stated that the head of quantitative who performed the modeling noted that Julius Baer already has a healthy amount of small cap exposure embedded in the current structure and that there was no need to acquire an additional small cap manager.

Ms. Jadallah reviewed the following structures, with two alternatives, to *SamCERA*'s international equity structure:

Current portfolio: 50% Core Value, 50% Core Growth

Alternative 1: 51.5% Core Value, 48.5% Core Growth

Alternative 2: 40% Core Growth, 40% Core Value, 20% Quantitative Manager



In order to minimize style risk, Alternative 1 gives a slightly higher allocation to *SamCERA*'s core value manager (from 50% to 51.5%) while decreasing the allocation in *SamCERA*'s core growth manager (from 50% to 48.5%).

Alternative 2 adds a third diversifying manager. The structure adds a quantitative, moderate tracking error manager with benchmark-like portfolio characteristics and would lower style risk and tracking error just slightly.

Ms. Jadallah stated that SIS is quite pleased with *SamCERA*'s current structure. Both current managers are staying true to their investment style. The current international equity structure has allowed *SamCERA* to rank in the top third amongst its peers. Ms. Tashman asked Ms. Jadallah about the impact of increasing *SamCERA*'s 20% percentage cap in emerging markets. Ms. Jadallah said that the MSCI ACWI-Ex US Index weighting in emerging markets has grown to the extent that Julius Baer's overweight to emerging markets is not a significant overweight. After some discussion, the Investment Committee was comfortable with *SamCERA*'s current 20% emerging market cap, especially given the uncertainty in Julius Baer's bets in Eastern European banks.

**Motion** by Bryan, second by Colson, carried unanimously to recommend to the board to maintain *SamCERA*'s current international equity manager structure, increasing the allocation to both managers by 3% each pursuant to *SamCERA*'s new asset allocation adopted at the January 2007 board meeting which had increased the total allocation to international equity by an additional 6% of total plan assets.

- 6.3 **Approval of Topics for Manager Review – Aberdeen Asset Management:** Mr. Clifton presented the proposed questions that will be forwarded to all of *SamCERA*'s fixed income managers. There is an additional question regarding Aberdeen's outsourcing its back-office operations to BNP Paribas. **Motion** by Bryan, second by Tashman, carried unanimously to recommend that the board approve the topics for Aberdeen Asset Management's annual review, as amended. The investment committee recommends that Aberdeen's annual review take place at the Investment Committee level.
- 6.4 **Approval of Topics for Manager Review – Pyramis Global Advisors:** Mr. Clifton presented the proposed questions that will be forwarded to all of *SamCERA*'s fixed income managers. There is nothing out of the ordinary to report with Pyramis' list of topics. **Motion** by Bryan, second by Tashman, carried unanimously to recommend that the board approve the topics for Pyramis Global Advisors' annual review, as amended. The Investment Committee recommends that Pyramis' annual review take place at the full board level primarily due to Pyramis' name change.
- 6.5 **Approval of Topics for Manager Review – Western Asset Management:** Mr. Clifton presented the proposed questions that will be forwarded to all of *SamCERA*'s fixed income managers. There are several additional questions being forwarded to Western Asset Management since the firm has a broader range of assets relative to *SamCERA*'s other two fixed income managers. Questions regarding the international and emerging markets/high yield aspects of the portfolio will be asked. **Motion** by Bryan, second by Tashman, carried unanimously to recommend that the board approve the topics for Western Asset Management's annual review, as amended. The Investment Committee recommends that Western's annual review take place at the Investment Committee level.

Mr. Hackleman then took up agenda item 6.2a.

- 7.0 **Other Business:** None
- 8.0 **Investment & Finance Manager's Report:** Mr. Clifton reported that the sub-prime mortgages make up less than one percent in both Aberdeen and Western Asset Management and are all AAA graded. He had not received a report from *SamCERA*'s third fixed income manager, Pyramis. Ms. Colson asked staff to include a question regarding the impact of sub-prime mortgage rate problems on other asset classes as a topic in all three fixed income manager reviews in May. Mr. Clifton also reported that Ms. Dames visited ACERA and spent some time with its investment team. She found the visit very educational.
- 9.0 **Adjournment:** There being no further business, Mr. Hackleman adjourned the committee at 2:58 p.m.