

**SONOMA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
INVESTMENT COMMITTEE MEETING MINUTES**

Thursday, March 24, 2022

8:33 a.m.

In accordance with Retirement Board Resolution #156, adopted on September 23, 2021 and reaffirmed on March 17, 2022, the Sonoma County Employees' Retirement Association Retirement Investment Committee meeting was held virtually and in compliance with California Government Code section 54953(e).

Individuals interested in participating in the meeting were invited to join using one of the two following methods:

1. WebEx meeting application via computer, tablet or smartphone:

<https://sonomacounty.webex.com/sonomacounty/j.php?MTID=m18ac52d9bf930bba7cf3f72bf031c6c0>

2. Dial-in:

1-408-418-9388

Meeting ID: 2489 438 4205

Password: 03242022

Public comments were solicited prior to the meeting by emailing rebecca.gay@sonoma-county.org. Members of the public that joined the WebEx meeting via the app or dial in were provided with the opportunity to submit live public comment for each agenda item after the Committee members and staff provided their comments.

Presiding in

SCERA Boardroom: Greg Jahn

Present

via WebEx: Trustees Travis Balzarini, Chris Coursey (left at 12:05 p.m.), Amos Eaton, Erick Roeser, Joe Tambe (left at 12:07 p.m.), and Brian Williams; Retirement Analyst Rebecca Gay and Finance and Retiree Services Manager Cheryl Enold

Also Present in

SCERA Boardroom: Trustees Tim Tuscany and Bob Williamson; Chief Executive Officer Julie Wyne, Assistant CEO/Chief Legal Counsel Christina Hess, Chief Investment Officer Jim Failor, Senior Investment Officer Steve Marsh, Administrative Aide Julia Smith

Also Present

via WebEx: Andrew Hsu, Aaron Prince, and Jeffrey Gundlach (of DoubleLine), John Lee, Tim Pflugradt, and Chris Behrns (of Aon); Aneesa Ayub, Joe Ebisa, Gar Chung, and Phil Gioia (members of the public)

Absent: Trustee Neil Baker (Alternate Retiree)

Greg Jahn, Chair
Erick Roeser, Vice Chair

I. RETIREMENT BOARD RESOLUTION #156 – COVID State of Emergency and imminent threat of risk

Recommendation: Affirm that the conditions set forth in Retirement Board Resolution #156 still exist and warrant continued application of Government Code section 54953(e) to SCERA Retirement Board and Committee meetings for the next thirty days through April 23, 2022.

A motion was made by Trustee Eaton, seconded by Trustee Williamson to affirm that the conditions set forth in Retirement Board Resolution #156 still exist and warrant continued application of Government Code section 54953(e) to SCERA Retirement Board and Committee meetings for the next thirty days through April 23, 2022. The motion carried 9-0-0-0 with voting as follows:

<u>AYES</u>	<u>NAYS</u>	<u>ABSTAIN</u>	<u>ABSENT</u>
Mr. Balzarini			
Mr. Coursey			
Mr. Eaton			
Mr. Jahn			
Mr. Roeser			
Mr. Tambe			
Mr. Tuscany			
Mr. Williams			
Mr. Williamson			

II. MINUTES APPROVAL

Approval of the February 24, 2022 Investment Committee meeting minutes

Recommendation: Approve the February 24, 2022 Investment Committee Minutes.

A motion was made by Trustee Eaton, seconded by Trustee Tambe to approve the February 24, 2022 minutes. The motion carried 8-0-1-0 with voting as follows:

<u>AYES</u>	<u>NAYS</u>	<u>ABSTAIN</u>	<u>ABSENT</u>
Mr. Balzarini		Mr. Williamson	
Mr. Coursey			
Mr. Eaton			
Mr. Jahn			
Mr. Roeser			

Mr. Tambe
Mr. Tuscany
Mr. Williams

III. PRESENTATIONS

- A. DoubleLine – Portfolio Manager Andrew Hsu and Senior Product Specialist Aaron Prince presented an update on the firm and the fixed income portfolio they manage for SCERA. Comments on the market were brief as markets were being covered in a separate presentation later in the meeting by DoubleLine's CEO & CIO, Mr. Jeffrey Gundlach. Staff noted that the portfolio was incepted seven and a half years ago and at the time, it was believed that DoubleLine's investment strategy with its focus on mortgages had the investment characteristic for a core plus fixed income mandate that would be complimentary to SCERA's two other core plus managers. The presenters were asked if they thought the investment thesis still stood and whether there were any perceived headwinds for a mortgage focused portfolio.

Mr. Prince provided a brief update on the firm and the history of the total return strategy, which he noted was created over 30 years ago by Mr. Gundlach. Turning back to the question, Mr. Hsu opined that the thesis still stood. Primarily he cited competitive performance over the longer-term but conceded that the portfolio had faced headwinds over more recent periods as rates fell to historic lows and mortgage refinancing reached all-time highs, which has an adverse effect on prepayment speeds for pools of mortgages. Mr. Hsu highlighted the recent performance history noting that post the March 2020 turmoil, relative performance has been mostly positive and that 2021 was a year of strong relative performance. He noted that for the February 2022 year-to-date period the portfolio had outperformed the Bloomberg US Aggregate Bond Index (the "Agg") by 1.1% per annum net-of-fees. Staff noted that this portfolio is monitored against dual benchmarks and the portfolio has outperformed both since inception. The secondary benchmark, a mortgage backed securities index, has underperformed the Agg (the primary and asset class benchmark) since inception by 0.57%.

Mr. Hsu then addressed the investment characteristics of core plus bond investing. He highlighted what he thought were the two key drivers of relative performance, which he described as credit and rates. His contention was that the strategy adopted by DoubleLine was less risky from a credit standpoint than most managers as just over half the securities held are guaranteed by the Government. In place of corporate credit, they substitute a broad range of structured credit products, where DoubleLine's preference is to be at the top of the credit stack with risk-seeking investors below them willing to absorb the initial tranche(s) of potential losses. In contrast, he argued that typical core

plus managers strive for benchmark excess returns by taking on credit risk in corporate and high yield bonds. Switching to rates, the second driver, Mr. Hsu extolled the virtues of managing convexity in the mortgage market such that declines in value due to interest rate rises were more muted and do not offset the benefit of the extra yield earned on mortgage securities. Regarding positioning, he covered some of the high-level statistics, noting that the coupon on the portfolio was 3.7%, which is higher than the benchmark's 2.4%. They also continue to have a lower duration at 4.8 years for the portfolio compared to the benchmark's 6.6 years. Regarding sectors, Mr. Hsu pointed out that just over half of the portfolio had virtually no credit risk due to the Government guarantees. They employ a "barbell" strategy that operates as a seesaw with non-credit risk assets driven by interest rates alone on one side and assets with credit risk that are driven by rates and credit spreads on the other side. The strategy aims to earn a higher yield than the benchmark while balancing the portfolio's rate and credit risks.

After the first presentation by DoubleLine with Mr. Hsu and Mr. Prince, the meeting proceeded to IV.C., the review by Aon of SCERA's Fixed Income portfolio structure and then returned to DoubleLine at 10:00 am for Mr. Gundlach's presentation.

Mr. Gundlach completed the DoubleLine presentation with a review of markets. The presentation was interactive with questions from Trustees and staff. Among the topics covered were the current levels and future path of interest rates, the shape of the yield curve and its implications for the economy, inflation, the outlook for the US dollar, the twin deficits (trade and fiscal), the COVID-19 pandemic and its aftermath and the Russian invasion of Ukraine. Mr. Gundlach concluded with some thoughts on assets that may help ride out turbulent financial markets which he believed would experience tail risks in the next five years.

IV. INVESTMENT CONSULTANT & STAFF

A. Farmland Manager Search – update

Staff updated the Board on the Farmland manager search finals which took place on March 9, 2022 with Aon and staff. There was one contender that staff and consultant felt was the best fit and complementary to the Plan's existing Farmland fund but that candidate is still being rated by Aon Townsend. If and when Townsend rates the strategy a "Buy", staff intends to bring forward a recommendation to engage subject to satisfactory on-site due diligence and acceptable terms and conditions.

B. Cash Planning & KKR DCIF Capital Calls

Staff presented an analysis of the current allocation of physical assets compared to policy guidelines. It was noted that normally this would have triggered a full rebalance

but the Board had approved a suspension of such rebalancing while SCERA is in the process of funding the additional investments in Real Assets. Staff presented projections of future cash balances together with major anticipated cash flows. A significant event is that KKR have made the first capital call with \$54 million to be wired on April 1, 2022. Staff also included an estimate for the County contribution in July/August. Staff showed the Board a provisional plan to sell down some equity holdings to raise the balance of the KKR commitment (\$81 million), using current cash and the annual County contribution to pay monthly expenses. No objections to the plan were raised by the Board.

C. Aon Review of SCERA's Fixed Income Portfolio Structure

Mr. Behrns introduced his presentation by noting that we periodically review the structure of each of our major asset classes and today we were reviewing Fixed Income. He explained that the purpose of the presentation was to outline Aon's "best thinking" approach and relate the concepts to SCERA's own Fixed Income portfolio. Mr. Failor reminded the Board that they had approved an asset allocation policy change that would increase Real Assets from 20% to 26% with a corresponding decrease of 6% in Fixed Income, going to a policy weight of 12%. He further noted that, while the asset class targets are in the Investment Policy Statement (IPS), in order to raise cash or rebalance the portfolio staff has operational targets for every individual manager account.

Mr. Behrns reviewed the current manager and strategy allocations together with the investment characteristics of the Core-Plus Fixed Income and Alternative Fixed Income portfolios. He then compared SCERA to the Aon model portfolio which represents Aon's guidance if building a portfolio from scratch. This was followed by a review of Fixed Income's role in the Plan's total portfolio.

Mr. Behrns provided an analysis of the investment performance of the Fixed Income class noting that it has been a successful program that has added value to the benchmark over time. All three Core-Plus managers outperformed the benchmark since their account inceptions and the Bank Loan portfolio (Alternative Fixed Income) has also been accretive to the performance of the Fixed Income asset class. The prior exposure to Unconstrained Bonds was less successful as the two managers both underperformed their respective benchmarks and the overall asset class benchmark. They have since been terminated but their impact remains within the asset class' historical results. Mr. Behrns then covered why Aon prefers active management in Fixed Income over the passive products available, which capture only a segment of the total market.

Mr. Behrns then reviewed the current Core-Plus Fixed Income portfolio outlining the investment styles of each of the three managers together with an analysis of the correlations of excess returns. The low correlations of excess returns underscored the

complimentary nature of the existing managers with staff noting how uncorrelated the excess returns for Reams were. Aon and staff both view Reams is a “high confidence” manager and warranting a larger relative allocation. Mr. Failor pointed out that in other asset classes SCERA has increased the allocation for its “highest confidence” managers. Mr. Behrns expressed their support for this higher weighting but did note that we should be prepared for somewhat greater volatility over shorter periods as Reams is willing to be more aggressive in taking advantage of market dislocations.

Mr. Behrns then reviewed various scenarios for structuring the Core Fixed Income portfolio including the preferred option of staff and consultant. Staff and consultant recommend keeping the existing three-manager Core Fixed Income structure, but move from equal weighting to operational manager targets that leave Reams with a greater weight and with the weight of the other two managers split equally (i.e., 5%, 3.5% & 3.5%). Staff pointed out that the transition will be gradual as the additional commitments to Real Assets have yet to be fully funded. Mr. Behrns concluded his presentation with a primer on Multi Asset Credit (MAC), which in their model portfolio would take the place of Bank Loans. He compared and contrasted the strategy with traditional Fixed Income and Unconstrained Bond strategies. The Board appreciated being apprised of Aon’s current thinking but the consensus was that there was not enough attraction in MAC to replace the existing Bank Loan portfolio.

Recommendation: Approve new Fixed Income portfolio structure, as outlined in the Aon presentation, to be implemented over time as Real Assets are expanded and with staff being granted the discretion through the transition to minimize costs.

A motion was made by Trustee Tambe, seconded by Trustee Williamson to approve the new Fixed Income portfolio structure, as outlined in staff/Aon recommendation in the Aon presentation, to be implemented over time as Infrastructure and Farmland are expanded and with staff being granted discretion during the transition to minimize costs. The motion carried 8-0-0-1 with voting as follows:

<u>AYES</u>	<u>NAYS</u>	<u>ABSTAIN</u>	<u>ABSENT</u>
Mr. Balzarini			Mr. Coursey
Mr. Eaton			
Mr. Jahn			
Mr. Roeser			
Mr. Tambe			
Mr. Tuscany			
Mr. Williams			
Mr. Williamson			

D. Russian Invasion of Ukraine

Mr. Failor introduced the topic, noting that the Aon paper described the ramifications from an asset allocation point of view and a second paper covered the benchmark implications and the impact on passive management. He commented on the Press Democrat article, where because of the Rule of Law restrictions SCERA was able to report that we have only a small exposure to Russia. This was followed by Ms. Wyne who provided the background to proposed State law regarding Russian exposure. She commented that the bill has momentum and is likely to get to the Governor's Desk. Ms. Wyne also reported on the submission of a letter of concern from the SACRS Legislative Committee to the SACRS Board of Directors for their approval to send to the bill's author, Senator McGuire.

V. COMMUNICATIONS

- A. SCERA Investment Performance Report, February 2022.
- B. Davidson Kempner Due Diligence Meeting Report, December 9, 2021.
- C. JP Morgan Real Estate Americas Client Letter, March 15, 2022.
- D. PIMCO, "Carbon Cap-and-Trade: We See a Compelling Opportunity", December 15, 2021.
- E. Wall Street Journal, "Rollback of Xi Jinping's Economic Campaign", March 15, 2022.

VI. GENERAL DISCUSSION MATTERS

Opportunity was given to advise the Investment Committee of new matters and for Committee members to ask questions for clarification, provide to staff, request staff to report back on a matter, or direct staff to place a matter on a subsequent agenda.

There were no general discussion matters.

VII. PUBLIC COMMENT

Opportunity was given for public comment on non-agenda items within the jurisdiction of the Investment Committee.

There were no public comments.

VIII. NEXT MEETING

The next Investment Committee meeting is currently scheduled for Thursday, April 28, 2022 at 8:30 a.m. via WebEx. Planned presentations for this meeting include a presentation by State Street.

IX. ADJOURNMENT

With no further business to conduct, the meeting adjourned at 12:22 p.m.

X. APPROVAL

The above minutes from the March 24, 2022 Investment Committee meeting were approved at the Investment Committee meeting on April 28, 2022.

GREG JAHN, CHAIR