

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

Thursday, May 25, 2023

8:36 a.m.

Presiding: Greg Jahn, Chair

Present: Trustees Neil Baker (Alternate Retiree – voted on item I.), Travis Balzarini, Joe Tambe, Tim Tuscany (arrived at 9:15 a.m.), and Brian Williams; Assistant CEO/Chief Legal Counsel Cristina Hess, Chief Investment Officer Jim Failor, Investment Officer Mickey Nguyen, Retirement Analyst Rebecca Gay, and Administrative Aide Julia Smith; Tom Klugherz and Jason Curran (of JP Morgan); John Lee and Tim Pflugradt (of Aon)

Present via

Zoom: Phil Kivarkis, Chris Behrns, Joe Romanies, and Kurt Weber (of Aon)

Absent: Trustees Chris Coursey, Amos Eaton, Erick Roeser, and Bob Williamson

Public comments were solicited prior to the meeting by emailing Rebecca.Gay@sonoma-county.org. Members of the public that joined the Zoom meeting were provided opportunity to submit live public comment for each agenda item after the Committee and staff provided their comments.

I. MINUTES APPROVAL

Approval of the April 27, 2023, Investment Committee meeting minutes.

Recommendation: Approve the April 27, 2023, Investment Committee Minutes.

A motion was made by Trustee Williams, seconded by Trustee Balzarini, to approve the April 27, 2023, Investment Committee meeting minutes. The motion carried 5-0-0-4 with voting as follows:

Mr. Baker	Aye
Mr. Balzarini	Aye
Mr. Coursey	Absent
Mr. Eaton	Absent
Mr. Jahn	Aye
Mr. Roeser	Absent
Mr. Tambe	Aye
Mr. Williams	Aye
Mr. Williamson	Absent

II. PRESENTATIONS

A. JP Morgan – Executive Director & Portfolio Manager Jason Curran along with Executive Director & Investment Specialist Tom Klugherz provided an organizational update,

commented on the real estate market and reviewed the performance and positioning of the Strategic Property Fund (SPF) in which SCERA invests. Mr. Klugherz announced that Mike Kelly, Head of Real Estate Americas, will be retiring in the first quarter of 2024 and that a search for a successor is underway. Commenting on the performance disparity relative to the NCREIF-ODCE benchmark, he pointed out the wide dispersion of returns of the underlying funds was largely due to the difference in timing of different fund valuations and write-downs taken earlier than other index constituents.

Mr. Curran discussed the three high conviction themes reflected in the fund positioning: a favorable view on the industrial sector, timely divestitures in office and retail, and a focus on single family rental (SFR) and storage sectors where rent growth is healthy. The -9.0% gross return for SPF over the trailing three quarters through the first quarter of 2023 is largely driven by an 11% depreciation in property values, mostly in the Office and Industrial sectors. He argued this demonstrates the efficiency of their valuation process. Full appraisals are done annually and updates quarterly, so that a quarter of assets are appraised fully each quarter. This short-term repricing is now filtering through to long-term results. Turning to specific sectors, office properties are bifurcated both operationally and fundamentally, but Mr. Curran highlighted a recent uptick in leasing activity which has been a pleasant surprise. However, he did project that industry wide around 20% of office space may disappear. In some cases, this 20% may be converted to other uses such as "last-mile" industrial space. Mr. Curran also reviewed net operating income (NOI) growth exceeding expectations in retail and increasing at an 11% rate over the next 5 years for industrial. Regarding the balance sheet, loan maturity is limited over the next 2 years, and almost 80% of debt is at a fixed rate or hedged. SPF's \$5 billion redemption queue is in lock step with peers who are also seeing redemptions driven overwhelmingly by rebalancing activity and not full redemptions.

The Board and staff commented that JP Morgan is very capable and professional but that SPF's size and ability to maneuver may be a factor contributing to the disappointing lack of alpha generation over recent multi-year periods.

III. INVESTMENT STAFF AND CONSULTANT

The Investment Committee moved into Executive Session and closed the meeting to all attendees who were not necessary for the consideration of existing litigation. While the meeting was closed, those attendees exited the Board room and/or were electronically blocked by the Zoom host and did not hear nor see the meeting.

A. Executive Session

Executive Session. Meeting closed pursuant to Government Code Section 54956.9(d)(1) to confer with legal counsel – existing litigation, *Iowa Public Employees' Retirement*

*System, et al. v. Bank of America, et al. and Swiss Bundesverwaltungsgericht
Administrative Appeal Case Reference B-2189/2023.*

The Investment Committee moved out of Executive Session and reopened the meeting to all attendees that were previously blocked.

B. Executive Session Report Out

Ms. Hess reported there was no reportable action taken by the Investment Committee during the Executive Session.

C. Arrowstreet Non-US Equity Account Recommendation

CIO Jim Failor reviewed the background and history of SCERA's investment with Arrowstreet from a long-only non-US equity mandate in 2011 that was moved to an International 130/30 fund in 2017. Arrowstreet manages a 130/30/20 strategy which is viewed by our consultant as a more efficient implementation of the 130/30 approach and Arrowstreet has been shifting assets away from the latter. As a result, SCERA is the only remaining investor in the International 130/30 fund and will bear higher administrative fees as the sole investor. Mr. Failor explained that the capability to position the portfolio with the extra 20% exposure allows the portfolio's beta to remain closer to 1. Arrowstreet, and our consultant, therefore, view this extra 20% as more of a risk management tool than a beta leverage tool. Additionally, the higher tracking error is reasonable for the projected extra return, and historical performance, which goes back to June 1, 2015, and is consistent with the 5.5% targeted value add.

Although the management fee of 25 bps and a 20% performance fee remains the same under each fund, Investment Officer Mickey Nguyen discussed the matter of transitioning to Arrowstreet's new methodology for calculating performance fees. Only if SCERA chooses to stay in the 130/30 fund will SCERA retain the option to choose whether to continue with the old (current) method or transition to the new method. Staff ran various scenarios to determine the effective total fee rates under different market cycles and alpha levels. The results showed the new method generally delivered lower fees over long time periods of rising markets, but over shorter time periods with flat to down markets, the new method could result in a higher performance fee.

Mr. Failor raised the issue of the Investment Policy Statement (IPS), noting that the 130/30/20 strategy is a commingled fund and, as a result, not subject to SCERA IPS investment guidelines but that the strategy would not be consistent with guidelines that apply to separately managed partial short-extension strategies, like the Arrowstreet strategy. He suggested we synchronize the guideline language in the IPS to eliminate this inconsistency. Trustees discussed this and the consensus was that this synchronization was preferable.

Recommendation: Move SCERA's non-US equity allocation with Arrowstreet from their 130/30 fund to their 130/30/20 fund.

A motion was made by Trustee Tambe, seconded by Trustee Balzarini, to move SCERA's non-US equity allocation with Arrowstreet from their 130/130 fund to their 130/30/20 fund. The motion carried 5-0-0-4 with voting as follows:

Mr. Balzarini	Aye
Mr. Coursey	Absent
Mr. Eaton	Absent
Mr. Jahn	Aye
Mr. Roeser	Absent
Mr. Tambe	Aye
Mr. Tuscany	Aye
Mr. Williams	Aye
Mr. Williamson	Absent

- D. 2023 Asset-Liability Study Overview – Partner Phil Kivarkis and Senior Consultant Joe Romanies, both of Aon Investments USA, previewed the upcoming Asset-Liability (A/L) study. Mr. Kivarkis introduced the rationale behind setting long term asset allocations and how that relates to investment risk and supports plan liabilities. The A/L study seeks to balance the growth of assets with liabilities. He provided an overview of SCERA's historical A/L profile and noted that SCERA's expected return assumptions have generally been at the more conservative end of the range of peer assumptions. As of March 31, 2023, the asset hurdle rate was 10.06% and the total expected asset growth rate was 10.98%, thereby exceeding the liability hurdle rate by 92 bps. So, these expectations project that, all else equal, the Plan will be 100% funded in 10 years. August 2023 is the anticipated timing for the final results of the A/L study to be presented to the Investment Committee. In response to trustee comments regarding the consideration of a Cost of Living Adjustment scenario, it was suggested that a separate mini Asset Liability study could be requested. Trustees emphasized the importance of this study to help shape policy direction with suitable investment selections.
- E. First Quarter 2023 Investment Performance Report – Investment Consultant Tim Pflugradt of Aon Investments USA, presented. Mr. Pflugradt reported that equities had a strong quarter driven by falling inflation data. Also noteworthy was the style reversal from the previous year's returns, as growth outperformed value across the range of market capitalizations for the first quarter, in part due to the bank exposure in value indices weighing heavily on performance during the outbreak of bank failures. Since SCERA's equity managers generally lean toward value, those managers posted lackluster results. The Plan returned 3.7% net of fees, underperforming the policy return of 4.6% for the quarter.

- F. May Cash Raise and the Plan's Asset Allocation – Investment Officer Mickey Nguyen gave a brief review of the \$60 million cash raise initiated on May 1, 2023. \$12 million was trimmed from DoubleLine and PIMCO each for a total of \$24 million from the Core Plus Fixed Income managers. The remaining \$36 million was raised from the Non-US Equity managers: \$20 million from Arrowstreet and \$16 million from State Street Global Advisors. With those funds now settled, cash available for capital calls and payroll is almost \$79 million. Staff is earmarking \$30 million of that balance for the next two months of payroll and expenses, and the remainder will cover potential capital calls from Fiera Comox, where \$102 million has not yet been called. Asset allocation percentages are within policy targets, although the weight of Total Fixed Income is moving toward the lower end of the range which is appropriate given that, once more than half of the Fiera Comox commitment is called, we will be increasing the Farmland policy weight, with two-thirds of that allocation sourced from a decrease in the Fixed Income policy weight.

IV. COMMUNICATIONS

- A. SCERA Investment Performance Report for April 2023.
CIO Jim Failor reported the Plan returned 0.7% for the month of April versus 0.85% for the target policy benchmark. A standout underperformer was the UBS Trumbull Property Fund which returned -7.05% in the first quarter of 2023 versus -3.17% for the NCREIF-ODCE index. Mr. Failor reminded the Board that the Committee planned to review the status of this account in late 2023 as the 4-year loyalty fee discount lockup is ending.
- B. Aon Flash Report, "PIMCO Core Plus . . . Moved to In Review", May 19, 2023.
- C. Reams Letter Regarding the Retirement of Steve Vincent, Head of Structured Products, April 27, 2023.
- D. The Telegraph, "Half of America's banks are potentially insolvent . . .", May 2, 2023.
- E. Business Insider, "No office tower is safe from the roiling market . . .", May 10, 2023.
- F. Segal/NIRS/Lazard, "Examining the Experiences of Public Pension Plans Since the Great Recession", presented at the Spring 2023 SACRS Conference, October 13, 2022.

V. GENERAL DISCUSSION MATTERS

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

Ms. Smith reminded the Trustees that the Board meeting on June 22, 2023, will begin at 9:30 a.m. This time change was made to accommodate a longer than expected Disability Committee

meeting earlier that morning.

VI. PUBLIC COMMENT

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

There were no public comments.

VII. NEXT MEETING

The next Investment Committee meeting is scheduled for Thursday, June 29, 2023, at 8:30 a.m. Planned topics for this meeting include a presentation by Guggenheim. All meetings are held at SCERA in the Board Room at 433 Aviation Boulevard, Suite 100, Santa Rosa, CA, and broadcast via Zoom unless otherwise noted.

VIII. ADJOURNMENT

With no further business to conduct, the meeting adjourned at 12:00 p.m.

IX. APPROVAL

The above minutes from the May 25, 2023, Investment Committee meeting were approved at the Investment Committee meeting on June 29, 2023.

GREG JAHN, CHAIR