



Executive Staff:

Richard Stensrud  
Chief Executive Officer

Scott Chan  
Chief Investment Officer

Robert L. Gaumer  
General Counsel

Kathryn T. Regalia  
Chief Operations Officer

John W. Gobel, Sr.  
Chief Benefits Officer

Members of the Board of Retirement

Rick Fowler, President  
Appointed by the Board of Supervisors

John B. Kelly, Vice President  
Appointed by the Board of Supervisors

Keith DeVore, Vice President  
Appointed by the Board of Supervisors

Michael DeBord  
Elected by the Retired Members

James A. Diepenbrock  
Appointed by the Board of Supervisors

Diana Gin  
Elected by the Miscellaneous Members

Kathy O'Neil  
Elected by the Miscellaneous Members

Chris A. Pittman  
Elected by the Safety Members

Julie Valverde  
Ex Officio, Director of Finance

John Conneally  
Elected by the Safety Members

Martha J. Hoover  
Elected by the Retired Members

## MINUTES

### RETIREMENT BOARD MEETING, WEDNESDAY, AUGUST 20, 2014

A regular meeting of the Retirement Board was held in the Sacramento County Employees' Retirement System Administrative Office, 980 9th Street, 19th Floor, Sacramento, California, on Wednesday, August 20, 2014, and commenced at 10:04 a.m.

#### OPEN SESSION:

##### PUBLIC COMMENT:

1. None heard.

##### MINUTES:

2. The Minutes of the July 18, 2014 regular meeting were approved on Motion by Mr. Diepenbrock; Seconded by Ms. O'Neil. Motion carried (9-0).

##### CONSENT MATTERS:

Items 3-13

The Consent Matters were acted upon as one unit upon a Motion by Mr. DeVore; Seconded by Mr. Pittman. Motion carried (9-0).

3. BLANAS, Jennifer: Granted a nonservice-connected disability retirement.

4. O'BRIEN-JAY, Teresa: Granted a nonservice-connected disability retirement.
5. LANGSTON, Angela M.: Granted a nonservice-connected disability retirement.
6. FROST, Paula M.: Granted a reciprocal nonservice-connected disability retirement.
7. Approved the final reconciliation of employer contributions for Sacramento County for fiscal year 2013-2014.
8. Received and filed the Selected Fees and Costs for Outside Legal Services for the Quarter Ended June 30, 2014.
9. Received and filed the Semi-Annual Administrative Expense Report for the Six Months Ended June 30, 2014.
10. Received and filed the Portfolio Re-Balancing Report for the Quarter Ended June 30, 2014.
11. Received and filed the July 2014 Monthly Investment Portfolio Activity Report.
12. Received and filed the Trading Cost Report for the Quarter Ended June 30, 2014.
13. Received and filed the July 2014 Monthly Investment Manager Compliance Report and Watch List.

**ADMINISTRATIVE MATTERS:**

14. Chief Executive Officer Richard Stensrud provided an update on developments affecting public retirement systems and on miscellaneous system and staff activities.

Mr. Stensrud reported that SCERS had conducted three retirement planning seminars this year that have been very popular. Chief Benefits Officer John Gobel stated that 586 members had attended those three seminars.

Mr. Stensrud noted that the California Association of Public Retirement Systems (CALAPRS) would be holding a trustee roundtable on Friday, September 12 in Los Angeles. Mr. Stensrud noted that Board Members interested in attending should contact Staff for assistance.

Mr. Stensrud reported that CALAPRS recently held its annual Principles of Pension Management for Trustees education program at Stanford and that Board Members Chris Pittman and Martha Hoover attended. Mr. Pittman noted that the program was excellent and that there was a lot of beneficial information, especially for newer trustees.

**ADMINISTRATIVE MATTERS (continued):**

Mr. Stensrud reported that the State Association of County Retirement Systems (SACRS) recently held its annual investment education program at UC Berkeley and that Board Member John Kelly attended. Mr. Kelly noted that the program was an excellent learning opportunity.

Mr. Stensrud noted that the Board had recently been provided a report on the progress of the strategic planning goals and objectives. Mr. Stensrud stated that the Board would continue to receive regular updates on the progress.

Mr. Stensrud reported that, as one of the implementation elements of the strategic plan, Staff had begun analysis regarding a potential computer system upgrade. Mr. Stensrud noted that currently, Staff uses multiple systems to perform their work with members and retirees, as well as for accounting and investments. Mr. Stensrud stated that SCERS Staff and members of the County's Department of Technology (DTech) have been working to identify requirements for a possible replacement system and determine whether there was the potential for a comprehensive system in the marketplace. Mr. Stensrud reported that Staff would be providing the Board with information on the project and the Board would have an opportunity to provide feedback. Mr. Stensrud noted that this would be a multi-step project, and that the Board would have the opportunity at key junctures to determine whether the project should move forward and/or what the project entails. Mr. Stensrud stated that with the scope of this project, the work done at the beginning of the process would be critical to prevent missteps during the implementation of the system. Mr. Stensrud reported that to that end, Staff anticipated that in the near future Staff would discuss with the Board the need for a consultant who could assist Staff with further mapping the requirements of a replacement system and help to prepare an RFP to find a vendor to provide a replacement system.

Mr. Stensrud reported that there had been a court decision regarding the proposed ballot initiative in Ventura County that would have had a significant impact on that county's retirement system and its future operation. Mr. Stensrud stated that the court ruled that the ballot initiative was illegal and would not be allowed to go to the voters. Mr. Stensrud noted that the decision was not going to be appealed, but that the group supporting the initiative was focusing on a potential statewide ballot initiative for pension reform for 2016.

Mr. Stensrud reported that CalPERS had recently announced that they would be counting numerous additional pay elements beyond base pay as pensionable compensation under the new CalPEPRA tiers. Mr. Stensrud noted that this decision had generated criticism in the press. Mr. Stensrud stated that CalPERS' decision had not altered Staff's view that pensionable compensation under CalPEPRA is limited to base pay and that no change to SCERS' approach was warranted at this time.

**ADMINISTRATIVE MATTERS (continued):**

15. Chief Operations Officer Kathryn Regalia presented the proposed final SCERS budget for the 2014-2015 fiscal year. Ms. Regalia indicated that there were no changes from the preliminary budget request that the Board approved at the June meeting.

Motion by Mr. Diepenbrock to accept the proposed final SCERS budget for the 2014-2015 fiscal year; Seconded by Mr. DeBord. Motion carried (9-0).

16. General Counsel Robert Gaumer and Chief Benefits Officer John Gobel presented the annual report on the processing of applications for disability retirement benefits.

Mr. Gaumer discussed the increased effort to complete disability applications in an efficient manner over the past year, especially applications that go to a hearing. Mr. Gaumer stated that the number of cases resolved by hearings in 2013-2014 more than doubled from the previous year, from 13 to 27. Mr. Gaumer also stated that there were 22 Staff recommendations to grant disability applications during this time. Mr. Gaumer noted that the average processing time had increased in 2013-2014, but that this was due to the large increase in cases resolved by hearings as those cases take longer. Mr. Gaumer discussed the additional costs associated with the increase in hearings.

Mr. Gaumer noted that the total number of accepted applications had declined slightly over the past three years, from 65 in 2011-2012 to 62 in 2012-2013 to 55 in 2013-2014. Mr. Gaumer stated that the number of in-process cases had remained steady during those three years, going from 100 to 92 to 93.

Mr. Gaumer stated that Staff was in the process of preparing amendments to the bylaws covering the processing of disability applications in order to improve the efficiency and cost effectiveness of the process. Mr. Gaumer noted that Staff expected to bring those proposed amendments to the Board by the end of the year.

Chief Executive Officer Richard Stensrud noted that the percentage of retirees with disability benefits as compared to the total number of retirees has declined over the last three years, going from 6.5% to 6.4% to 6.1% for miscellaneous retirees and from 14% to 13.7% to 13.1% for safety retirees. Mr. Stensrud stated that this reflects an increase in the total number of retirees rather than a decrease in the number of retirees with disability benefits. Mr. Stensrud further noted, however, that these percentages were very much at the low end relative to other 1937 Act retirement systems.

Motion by Mr. Diepenbrock to receive and file the annual report on the processing of applications for disability retirement benefits; Seconded by Mr. DeVore. Motion carried (9-0).

**INVESTMENT MATTERS:**

17. Patrick Thomas of Strategic Investment Solutions presented the Investment Performance Report for the Quarter Ended June 30, 2014.

Mr. Thomas reported that the Total Fund (TF) return for the third quarter, including the impact of the overlay program, was 3.5% gross of fees. The TF return was 0.1% above the policy index of 3.4%, and in line with the allocation index. The overlay program had no impact during the quarter.

Mr. Thomas reported that on a comparative basis, the return for the quarter was 0.3% below the Public Funds \$1+ Billion Median return of 3.8%. The TF return ranks in the 64th percentile in the InvestorForce Universe, which is the ranking universe used by SIS. All the major asset classes experienced positive returns for the quarter.

Mr. Thomas reported that at the asset class level, quarter outperformance occurred, gross of fees, in the fixed income, private equity, and real assets segments. Underperformance occurred in the domestic equity, international equity, hedge fund, and opportunistic segment.

Mr. Thomas reported that for SCERS' fiscal year ended June 30, 2014, the TF return gross of fees, including the impact of the overlay program was 16.6%, which was 1.0% above the return of the policy index benchmark return of 15.6%, and 1.1% above the allocation index return of 15.5%. The TF fiscal year return was 0.2% above the Public Funds \$1+ Billion Median return of 16.4%, and ranks in the 50th percentile in the InvestorForce Universe.

Mr. Thomas reported that at the asset class level, fiscal year outperformance versus the policy benchmark occurred, gross of fees, in the fixed income, hedge fund and real assets segments of the portfolio. Fiscal year underperformance versus the policy benchmark occurred, gross of fees, in the domestic equity, international equity, private equity and opportunistic segments of the portfolio.

Mr. Thomas reported that the annualized TF return gross of fees for three years of 9.9% is 0.4% above the policy index benchmark for the same period. The annualized TF return gross of fees for five years of 13.0% is 0.5% above the policy index benchmark for the period. The TF gross of fees return of 8.7% since the inception of SIS's data in June of 1986 is 0.2% below the Total Benchmark return of 8.9% for the period, but above SCERS' actuarial investment return assumption which has ranged from 8.25% to 7.50% (currently) during the period.

**INVESTMENT MATTERS (continued):**

Chief Investment Officer Scott Chan provided a presentation on qualitative considerations relative to SCERS' portfolio and the quarterly performance. Mr. Chan stated that SCERS has gone through three phases of portfolio construction over the past five years, including: (1) Establishing a target asset allocation that was intended to reduce risk and be resilient over different types of economic regimes; (2) Incorporating ranges for the components within asset classes to allow sub-asset class components to expand or contract based on the best risk adjusted returns; and (3) Restructuring every asset class. Mr. Chan noted that, with the investment cycle maturing, it was important to take advantage of these structural features to position the portfolio to protect against or capitalize on risk.

Chief Executive Officer Richard Stensrud reviewed the portfolio's returns over the past fiscal year, as well as over the past five years. Mr. Stensrud stated that with the 16.6% gross return during 2013-2014 and the 13.2% average gross return during the past five years, SCERS' asset base has increased from \$4.4 billion to \$7.8 billion during that period. Mr. Stensrud noted that over the past five years, SCERS has earned \$250 million in excess returns over the fund's policy benchmarks, meaning that SCERS' investment decisions had added \$250 million to the fund over what the market returned. Mr. Stensrud noted that the production of returns in excess of the benchmarks was a direct result of the Board's decision to expand SCERS' internal investment staff and that this decision, in itself, had produced a huge return on investment to SCERS' stakeholders.

Mr. Chan discussed the potential risks that Staff attempts to manage and mitigate, including: (1) Business cycle risk; (2) Market cycle risk; and (3) Valuation risk. Mr. Chan explained the three concepts, and how they interrelate, including that valuation often ties together the market cycle and the business cycle.

Mr. Chan then discussed dynamic investing across the business cycle, noting that many long term asset allocators such as pension funds do not pay much attention to the risks associated with tactical considerations. Mr. Chan stated that dynamic investing is not the same thing as market timing, which is particularly difficult given how hard it is to identify exact market peaks and troughs. Mr. Chan stated however, that by monitoring and understanding business cycle risks, market cycle risks, and valuation risks, it is easier to determine when assets are 'near' peaks and troughs, and avoid risks that are not justified by the returns. Mr. Chan noted that Staff considers its role to be risk managers in that Staff cannot control returns but can control and mitigate risk. Mr. Chan stated that as risk managers, Staff can avoid greater risks as a cycle nears its end.

**INVESTMENT MATTERS (continued):**

Mr. Chan reviewed the criteria Staff would use in making shifts to the portfolio, including considering the: (1) Absolute return; (2) Relative return; (3) Downside risk; and (4) Risk of doing nothing (i.e., risk homeostasis). Mr. Chan discussed the current market environment, noting that six years had passed since the 2008 credit crisis. Mr. Chan noted that, during those six years, artificially low interest rates and liquidity from the central banks had re-flated asset values. Mr. Chan stated that, based on Staff's analysis of the business cycle, market cycle, and valuations, it appears that it is time to consider taking profits to avoid future losses in areas that are richly valued and re-allocate the proceeds in areas with similar upside potential but quantifiably less business cycle risks, market cycle risks, and valuation risks.

Mr. Chan then discussed two examples of assets that exhibited cyclical risk – high yield bonds and core real estate – and discussed steps already taken and/or being considered to better position those sub-asset class components, and the overall portfolio.

Discussion followed.

Motion by Mr. Kelly to receive and file the quarterly report and to approve the recommendations made in the presentation; Seconded by Ms. Valverde. Motion carried (9-0).

18. Chief Investment Officer Scott Chan introduced Jennifer Young of the Townsend Group who along with SCERS Investment Officer J.R. Pearce provided a presentation on SCERS' separate account real estate portfolios.

Ms. Young reviewed an overview of SCERS' separate account real estate portfolio, noting that the target asset allocation to the separate account is 70% of the total real estate portfolio. Ms. Young stated that historical evidence suggests that actively managed separate accounts outperform open-end funds with less volatility as a result of lower leverage, greater buy/sell discipline, and potentially better stock selection, and that this was true of SCERS' experience.

Ms. Young stated that the separate accounts are currently managed by two managers, BlackRock and Cornerstone. Ms. Young reviewed the history of these accounts and then reviewed the separate account assets, detailing the type and location of the assets.

**INVESTMENT MATTERS (continued):**

Mr. Chan discussed ways in which Staff and Townsend added value to the portfolio through an active approach to overseeing the managers, including exhibiting a disciplined use of leverage, assessing acquisitions and dispositions, and reviewing business plans. Mr. Chan noted that Staff and Townsend had reviewed over 50 properties presented to them by Blackrock and Cornerstone over the past two years but had only purchased one, because the initial valuation or bidding on the properties had exceeded the valuation level that Staff and Townsend believed necessary for SCERS to obtain the desired level of return.

Investment Officer JR Pearce discussed the process that Staff and Townsend use when reviewing properties. Mr. Pearce then reviewed the one property purchased in the last few years. Mr. Pearce explained the process used to evaluate this property, as well as the history of this property since purchase. Mr. Pearce next reviewed one of the properties that SCERS had recently sold. Mr. Pearce covered the evaluation of this property and the decision made to sell this property.

Mr. Chan reviewed future considerations for the separate account real estate portfolio. Mr. Chan noted that Staff and Townsend believe that the market cycle is likely past the midpoint and that while there is still upside left, it is tempered by historic cyclicity of the market. Mr. Chan noted that historically price appreciation has only accounted for a small amount of returns as the boom and bust cycle of real estate levels out the appreciation. Mr. Chan stated that, according to their analysis, even investing at the midpoint of the cycle onward has generally not compensated investors for the risks. Mr. Chan stated that Staff and Townsend had identified potential properties to sell and that they plan to continue to be disciplined buyers. Mr. Chan noted that, unless real estate values drop, SCERS will likely be a net seller.

Discussion followed.

Motion by Mr. Diepenbrock to receive and file the presentation on SCERS' separate account real estate portfolios; Seconded by Mr. DeVore. Motion carried (9-0).

The meeting was adjourned at 1:34 p.m.

MEMBERS PRESENT: Richard B. Fowler II, John B. Kelly, Keith DeVore, Michael DeBord, James A. Diepenbrock, Kathy O'Neil, Chris Pittman, Julie Valverde, and John Conneally.

MEMBERS ABSENT: Diana Gin and Martha J. Hoover.



OTHERS PRESENT: Richard Stensrud, Chief Executive Officer; Scott Chan, Chief Investment Officer; Robert L. Gaumer, General Counsel; Kathryn T. Regalia, Chief Operations Officer; John W. Gobel, Sr., Chief Benefits Officer; Steve Davis, Deputy Chief Investment Officer; Thuyet Dang, Accounting Manager; JR Pearce, Investment Officer; John Lindley, IT Administrator; Patrick Thomas and John Nicolini, Strategic Investment Solutions, Inc; Steve Masarik, Cliffwater, LLC; Jennifer Young, The Townsend Group; Katie Briscoe, Nossaman LLP; Diana Ruiz, Deputy County Counsel; and Jeremy Zerbe, SCALE.

Respectfully submitted,

Richard Stensrud  
Chief Executive Officer and  
Secretary of the Retirement Board

APPROVED: \_\_\_\_\_  
Rick Fowler, President

DATE: \_\_\_\_\_

cc: Retirement Board (11); Board of Supervisors (6); County Counsel; County Executive (2); Internal Services Agency (2); County Labor Relations; Employee Organizations (20); Sacramento County Retired Employees' Association; SCERS Member Districts (10); Elected Officials (3); Superior Court of California, County of Sacramento; Amervest Company, Inc.; Mark Merin; John R. Descamp; and The Sacramento Bee.