

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

Thursday, August 25, 2022
8:34 a.m.

In accordance with Retirement Board Resolution #156, adopted on September 23, 2021, and reaffirmed on August 18, 2022, the Sonoma County Employees' Retirement Association 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=mad3edafe2d0c10fd255369ca4df89404>

2. Call-in:

1-408-418-9388

Meeting ID: 2484 104 3042

Password: 08252022

PUBLIC COMMENT PRIOR TO THE MEETING

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, Chair

Present via WebEx: Trustees Neil Baker (Alternate Retiree), Travis Balzarini (arrived at 8:39 a.m.), and Amos Eaton; Finance and Retiree Services Manager Cheryl Enold

Present in

SCERA Boardroom: Trustees Erick Roeser, Joe Tambe (left at 11:15 a.m.), Tim Tuscany, Brian Williams, and Bob Williamson (left at 11:16 a.m.); Chief Executive Officer Julie Wyne, Assistant CEO/Chief Legal Counsel Cristina Hess, Chief Investment Officer Jim Failor, Senior Investment Officer Steve Marsh, Retirement Analyst Rebecca Gay, and Administrative Aide Julia Smith

Also Present

via WebEx: Jon Simon, Derek Vance, and Peter Rathjens (of Arrowstreet); Chris Behrns, John Lee, and Tim Pflugradt (of Aon); Gar Chung and Joe Ebisa (journalists); Mickey Nguyen, Brian, Gregg, and three unnamed callers (members of the public)

Absent: Trustee Chris Coursey

Greg Jahn, Chair

Erick Roeser, Vice Chair

I. RETIREMENT BOARD RESOLUTION #156 – COVID State of Emergency and imminent threat 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 September 24, 2022.

A motion was made by Trustee Williams, seconded by Trustee Tuscany 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 September 24, 2022. The motion carried 7-0-0-2 with voting as follows:

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

II. MINUTES APPROVAL

Approval of the July 28, 2022, Investment Committee meeting minutes

Recommendation: Approve the July 28, 2022, Investment Committee Minutes.

A motion was made by Trustee Williamson, seconded by Trustee Williams, to approve the July 28, 2022 minutes. The motion carried 7-0-0-2 with voting as follows:

Mr. Balzarini	Absent
Mr. Coursey	Absent
Mr. Eaton	Aye
Mr. Jahn	Aye

Mr. Roeser Aye
Mr. Tambe Aye
Mr. Tuscany Aye
Mr. Williams Aye
Mr. Williamson Aye

III. PRESENTATIONS

- A. Arrowstreet – Peter Rathjens, Chief Investment Officer, Derek Vance, Co-Head of Research and Jon Simon, Client Relationship Manager provided an organizational update and commented on the performance and positioning as well as research relating to the 130/30 non-US equity fund in which SCERA invests.

Before the manager began their presentation, staff brought to the Board’s attention the large performance fee that had been earned by Arrowstreet for the year to June 2022. Manager fees are disclosed in the annual comprehensive financial report but, due to the magnitude of the Arrowstreet fee, staff wanted to remind the Board how it came about. Mr. Failor recounted the history of the relationship with Arrowstreet noting that they are a “high conviction” manager and that five years ago the mandate was broadened to move from a long only account to a partial short extension (130/30) account. At the time they offered several alternative fee proposals including various combinations of base and performance fees. SCERA opted for the lower base fee plus a somewhat higher performance fee combination. There is a “high water mark” so the annual performance fee is only earned if the strategy has added value since inception.

Mr. Failor described some of the pros and cons of performance fees noting that benchmark relative performance has been notably stronger than expected so for the 12-month period to end June 2022. Staff informed the Board that they had communicated with the manager to ask the question “*If performance has been so unusually strong, could it not be unusually weak in a future period?*” Arrowstreet had responded with some additional research which was added to the presentation.

Mr. Simon introduced the Arrowstreet team and thanked SCERA for the business and opportunity to address the Board. Dr. Rathjens commented that future expectations after a period of very strong performance was an important topic that was featured at their recent client conference. Dr. Rathjens noted that the value added from July 2020 to June 2021 (13.2%) and July 2021 to June 2022 (16.3%) was unusually strong and above long-term alpha expectations. He then described their risk controls and the dynamic nature of the process, noting that Arrowstreet’s aim is to exploit the mistakes of other investors. The last few years have seen investors under stress and in this type of environment behavioral mistakes become elevated. This provides Arrowstreet with a richer opportunity set and in

response they did become somewhat more aggressive and were able to capture a larger alpha. Environments with such rich opportunities are episodic and Arrowstreet dials down the aggression (tracking error) when they do not perceive that the market is providing high alpha potential. The long-term alpha expectation for the product reflects a mix of high and low opportunity periods.

Dr. Rathjens then covered the additional analysis requested by staff concerning the potential downside implications of recent strong performance. Dr. Rathjens presented analysis of how the since inception results that built up over time compare to expectations based on the strategies expected value add of 5% with a targeted tracking error of 6.5%. His analysis showed that since inception results have been good with no notable outliers relative to expectations. A similar analysis was presented for the realized active risk. It showed that, if anything, the realized risk is lower than the long-term target but as previously mentioned it has ticked up recently in response to the richness of the opportunity set. Dr. Rathjens concluded the analysis by considering the likelihood of negative results. Given the level of strategy alpha, tracking error and assuming a normal distribution, the expectation is skewed against negative results with a low probability of a negative event. Dr. Rathjens concluded with some comments on their investment philosophy which he summarized as “adding value by identifying signals that are relevant to price and less obvious to investors.”

Mr. Vance switched from performance and investment philosophy to cover the impact of ongoing research innovations. He emphasized that research is ongoing and produced an analysis of the correlation between model forecasts and actual results. The analysis showed that Arrowstreet has released enhancements at about the same pace as forecasting decay which has maintained the alpha producing potential of the strategy. In response to questions regarding proprietary data sourcing, Dr. Rathjens responded that he thought very little of the data was truly proprietary. The data they have in house on models, positions and actual results were totally proprietary. In terms of trying to lock in exclusive access to proprietary data he drew attention to potential compliance issues in that they would not want to inadvertently use material non-public information.

- B. Second Quarter 2022 Investment Performance Report – Consultant Tim Pflugrad of Aon Investment Consulting, presented. Mr. Pflugrad noted that overall, it was a weak quarter, with both equity and bond markets posting losses. Across international equity markets all the regions were weak over the quarter with major equity markets posting double digit losses. The global equity benchmark declined 15.8% for the quarter driven in large part by geopolitical uncertainty and higher interest rates amidst soaring inflation. The US market, as measured by the Russell 3000 Index, fell 16.7%. Within US equities, large cap stocks outperformed medium and small cap stocks, while value stocks outperformed growth stocks across the range of market capitalizations. All sectors generated negative returns

over the quarter, with the Consumer Discretionary and Technology sectors being the hardest hit.

In fixed income, the Bloomberg US Aggregate Bond Index was down 4.7% over the quarter as U.S. Treasury yields saw notable increases across the range of maturities. The 10-year Treasury yield rose 66 bps to end the quarter at 2.98%. The 30-year Treasury yield rose 75 bps to end the quarter at 3.14%. As expected, the U.S. Federal Reserve increased its benchmark interest rate by 75 bps, the largest rate increase since 1994. Within investment grade bonds, lower credit quality bonds underperformed higher quality issues with Baa bonds falling 7.9% in aggregate. High yield bonds fell even further posting a decline of 9.8%.

Turning to the Plan's performance, Mr. Pflugradt noted that the policy return was a negative 9.5% for the quarter. This was reduced by positive active management, resulting in an actual Plan return of negative 7.5%. He attributed this to the outperformance by the equity managers, where the strong relative performance from the partial short extension (130/30) strategies was particularly noteworthy and more than offset the underperformance in Real Assets.

- C. Annual Manager Evaluation Report and Risk Budgeting Analysis – Associate Partner Chris Behrns and Consultant Tim Pflugradt, both of Aon Investment Consulting, presented. Mr. Behrns acknowledged the length of the document but noted that he would only be covering the executive summary that precedes the individual manager reviews. He commented that the individual manager reports were included for reference purposes, but he was happy to answer any questions pertaining to them. Mr. Failor further noted that this year the summary only shows historical rankings for the current managers. However, a full set of historical rankings, including past managers, is included in the Appendix.

Mr. Behrns noted that none of the Plan's manager ratings had changed over the past year and most were rated "Buy", three were rated "Qualified" and none were rated "Sell". Mr. Behrns pointed out that the "Buy" rating represents Aon's best ideas and that only a few firms can be best ideas and hence "Buy" rated. Therefore, you can have competent managers with a strong "Qualified" rating who are not currently on their "best" ideas list. It was also noted that sometimes SCERA might have a different view from the consultant or weight an issue differently. Jacobs Levy is an example of this where staff has more confidence in the investment process and lesser concerns over the firm's ownership and succession planning. Similarly for Systematic, where Staff is less concerned about firm assets under management losses, provided they do not negatively impinge on Ken Burgess and his free cash flow strategy. It was pointed out by staff that both Jacobs Levy and Systematic are separately managed accounts with the assets custodied at State Street and under SCERA's control. This is not the case for the UBS Trumbull Property Fund, the

third manager with a “Qualified” rating. The Fund has a very large redemption queue and SCERA opted for the four-year loyalty fee reduction as they believed they could not get out quickly. In summary, Mr. Behrns commented that Aon views the Plan’s overall manager line-up is strong.

Having reviewed the manager evaluation report, Mr. Behrns switched to the risk budgeting analysis. Terms were defined and it was noted that the report was designed to answer the question of whether “the choice of managers within the various asset classes reduced risk through diversification” or not (i.e., were the manager’s styles complimentary to one another). Seven years of quarterly returns were used for the analysis, as the real assets portfolio uses quarterly data. Regarding the total Plan, Mr. Behrns highlighted that most of the overall risk comes from asset allocation and that the employment of active managers adds modest incremental risk, which reflects that the managers are complimentary to one another. (Mr. Failor noted that the manager correlation tables were included at the end of the presentation book.) Mr. Behrns covered each of the major asset classes, noting that where active management had added risk at the asset class level the increase was modest for US and Global Equity, slightly reduced for Non-US Equity and unchanged for Fixed Income and Real Assets.

IV. INVESTMENT STAFF AND CONSULTANT

A. Report Out from Executive Sessions on April 28, May 26, June 30 and July 28, 2022

Staff reported out the deliberations that took place within the closed sessions that resulted in staff and consultant recommending an investment of \$125 million in the Fiera Comox Global Agriculture Open-End Fund which would serve to implement the policy decision to increase Farmland from 5% to 8% of Plan assets. The recommendation, subject to a satisfactory on-site due diligence and reaching satisfactory terms and conditions, had been accepted by the Board.

B. Fiera Comox Global Agriculture Fund – update

Mr. Failor noted that staff had undertaken a satisfactory on-site due diligence with Fiera Comox in Montreal and reached agreement on satisfactory terms and conditions. All the necessary paperwork has been completed for SCERA to subscribe to the Fund. The Plan’s subscription was accepted on August 15th and the investment period began on August 16th.

C. Annual Alternative Investment Fee and Expense Disclosure, 2021 - per Government Code section 7514.7

Staff noted that the disclosures provided to the Committee complied with California law (Government Code section 7514.7) and that they also complied with the International Limited Partner Association (ILPA) template for such reporting. For SCERA, the

disclosure requirement currently applies to Davidson Kempner (DK) SOF Fund IV and the Axiom Infrastructure (AxInfra) North America II Fund. Going forward it will also apply to the investment in the KKR infrastructure fund and Fiera Comox farmland fund. Staff noted that they had found nothing egregious in the reports. There was a suggestion that some of the reporting could be made easier to read with a larger font.

D. 2022 Planning Session Draft Panel Seeding Questions

For the benefit of newer Board members, Mr. Failor noted that it has been three years since a Planning Session has been held. He noted that a major component was the asset class panel discussions and that the format has been to ask a few seeding questions at the beginning of each panel to start the conversation flowing. The seeding questions are developed by consultant and staff, approved by the Committee and provided to the panelists in advance. The trustees provided comments regarding the priority and ordering of the questions and Mr. Failor indicated that staff would re-order the questions before finalizing.

E. Additional 2022 County Contribution and Cash Planning

Mr. Marsh presented the asset allocation of the Plan relative to policy, noting that when the new policy is adopted (after 50% of the commitment to the KKR infrastructure fund is invested) that the Plan will be back in-line with policy. Staff showed a synopsis of significant cash events expected over the remainder of calendar 2022, thanking the County Treasurer for the additional contribution and noting that the Arrowstreet annual performance fee had been incorporated into the analysis.

V. COMMUNICATIONS

A. SCERA Investment Performance Report, July 2022.

Staff noted that July was a good month for absolute performance (+4.4%) but that in relative terms the Fund lagged the policy benchmark in July.

B. JP Morgan Global Real Estate Conference, September 20 to September 21, 2022.
The Fairmont Dallas, Dallas Texas.

Mr. Failor drew attention to the JP Morgan conference in Texas in September and the Aon client conference which is scheduled for December 7 to 8 in Miami, Florida. He asked Board members to contact him if they were planning on attending either of the conferences

C. UBS News Flash, "New appointment: Co-CIO of UBS Farmland Investors LLC",
August 2022.

D. The Economist, "China's mortgage boycotts are a symptom of a broader crisis",

August 9, 2022.

- E. The Telegraph, "Venture capitalists are clueless – the likes of Klarna and Uber prove it", July 17, 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 information 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 items.

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 scheduled for Thursday, September 29, 2022, at 8:30 a.m. via WebEx. Planned topics for this meeting include a presentation by UBS on their Trumbull Property Fund.

IX. ADJOURNMENT

With no further business to conduct, the meeting adjourned at 11:25 a.m.

X. APPROVAL

The above minutes from the August 25, 2022, Investment Committee meeting were approved at the Investment Committee meeting on September 29, 2022.

GREG JAHN, CHAIR