

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

Thursday, November 17, 2022
9:13 a.m.

In accordance with Retirement Board Resolution #156, adopted on September 23, 2021, and reaffirmed on October 20, 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=m3327de0b55c0cc8609b4bcfb4806661d>

2. Call-in:

1-408-418-9388

Meeting ID: 2491 124 0955

Password: 11172022

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 Travis Balzarini and Tim Tuscany; Finance and Retiree Services
Manager Cheryl Enold

Present in

SCERA Boardroom: Trustees Neil Baker (Alternate Retiree), Amos Eaton, Erick Roeser, Joe Tambe, Brian Williams, and Bob Williamson; Chief Executive Officer Julie Wyne, Assistant CEO/Chief Legal Counsel Cristina Hess, Chief Investment Officer Jim Failor, Investment Officer Mickey Nguyen, and Retirement Analyst Rebecca Gay

Also Present

via WebEx: Dan Valladares, James Cunningham, and Tony Haas (of KKR); Kevin Hrad and Chris Behrns (of Aon)

Absent: Trustee Chris Coursey

I. MINUTES APPROVAL

Approval of the September 29, 2022, Investment Committee meeting minutes

Recommendation: Approve the September 29, 2022, Investment Committee Minutes.

A motion was made and seconded, to approve the September 29, 2022, minutes. The motion carried 8-0-0-1 with voting as follows:

Mr. Balzarini	Aye
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. BOARD AND COMMITTEE MEETINGS

Retirement Board Resolution #156 – COVID State of Emergency and imminent threat of risk

Recommendation: Take appropriate action.

A motion was made by Trustee Eaton, seconded by Trustee Roeser 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 December 17, 2022. The motion carried 8-0-0-1 with voting as follows:

Mr. Balzarini	Aye
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. KKR – Partner James Cunningham as well as Anthony Hass and Daniel Valladares, both of the Client & Partner Group, provided an organizational update and commented on the performance and positioning of the Diversified Core Infrastructure Fund in which SCERA invests.

Mr. Cunningham leads the core investment strategy in North America and spent his career in energy and infrastructure. He reviewed SCERA's account history beginning with the initial commitment of \$135 million in June 2021. Since this time, capital has been consistently deployed with \$88 million of committed capital called and 35% of the total remaining. Therefore, the account has had two full quarters of performance, and IRR will be calculated after one full year. Full deployment of SCERA assets is expected in 1Q2023. (After this meeting, an additional \$40 million was called.)

Regarding the Fund itself, it was noted that KKR employees have \$520 million invested in it, so interests are aligned, and the Fund has invested \$6.2 billion thus far out of \$8.1 billion in commitments. Mr. Cunningham highlighted the power of KKR's platform and ability to leverage their global team to construct portfolios and source opportunities to deploy capital in the future. He then described the ways in which they think of portfolio diversification – diversifying across industries, regions and regulators. They build their portfolio to be resilient in times of crisis they seek out inflation hedged assets with limited sensitivity to economic cycles. KKR is interested in mature assets with clearly visible cash flows. Essential services such as utilities and data centers are examples. Given this, it was noted that during the first quarter of 2020 when COVID lockdowns were implemented, their portfolio assets were delivering free cash flow of 6%.

In response to a Trustee question regarding themes, Mr. Cunningham commented that they focus on developed OECD countries to mitigate geopolitical and regulatory risks. In addition, the Fund is truly “core” in that they look for more mature hard cashflow positive assets. Energy transition is one theme KKR wants to be involved in. On the topic of competition for infrastructure deals, Mr. Cunningham stressed that they are very disciplined and explained the value of their deep corporate relationships around the world. These relationships have been the source for most of their acquisitions and have resulted in attractive pricing. KKR believes this network of relationships will continue to benefit the Fund. The pipeline they are seeing today is quite robust and they have few direct competitors as most of their competitors are more “core plus” than “core” as they are.

The Trustees and staff discussed the presentation after KKR left the meeting. Mr. Failor noted that their comments were consistent with the strategy as previously communicated and that SCERA had benefitted from the vintage pooling with other Aon Clients to obtain a favorable “founder's fee”. The Trustees made positive comments about the manager's strategy and were impressed with the investment by employees in the Fund.

- B. Third Quarter 2022 Investment Performance Report – Associate Partner Chris Behrns of Aon Investment Consulting, presented.

Mr. Behrns commented that inflation had been leading the charge and had been a contributor to the decline in stock values over the third quarter. In addition, US dollar appreciation has also had a significantly negative impact on non-US stock returns. On the bright side, real estate, infrastructure, and farmland have generated positive returns over the period, proving that diversification is doing its job. Even bank loans have contributed positively over the quarter due to their floating-rate structure and have now reset at higher rates. A Trustee noted that the traditional 60/40 portfolio didn't provide the downside protection it was designed to provide over the recent period. In reference to a presentation slide of the US Treasury yield curve, Mr. Behrns explained the gradual inversion of the curve year-to-date (YTD) suggests that the economy is heading toward a recession or at a minimum will experience slowing growth. He also highlighted the stark dichotomy between private and public real estate returns which forewarns of the potential correction ahead for private real estate, which tends to lag the public (REIT) market. Overall, active management performed well over the quarter and YTD the Plan had outperformed 77% of other large public pension plans YTD.

IV. INVESTMENT STAFF AND CONSULTANT

A. Securities Lending Review – follow-up

During the Investment Committee Meeting held on September 29, 2022, Chief Investment Officer (CIO) Jim Failor along with Aon Custody Advisory Services (CAS) and State Street Securities Finance (SSSF), the Plan's securities lending (SL) agent, had presented a comprehensive background review of the SL program. Revenue from this program has declined significantly over recent years and for several reasons, including the use of the low-yielding Navigator Fund in which the collateral pool invests, as well as the lack of securities to lend resulting from SCERA's shift to commingled funds.

Staff has since had further discussions with CAS and SSSF and both have suggested we consider moving from the very conservative Navigator Fund for investing cash collateral to a modestly less conservative collateral pool, such as SSSF's Compass Fund. Such a move is estimated, under current market conditions, to increase the revenue of the program from the current \$30-\$50K per year to a range of \$75-\$100K. Staff recommended employing Aon CAS to formally review the securities lending program in light of this preliminary analysis.

A few trustees expressed continued confusion as to the SL program's structure and wanted to defer to staff's recommendation on the topic. Another trustee inquired about the effect of interest rates on revenue projections. While a trustee voiced concern over the amount of Board time spent on this issue, the majority view was to review the program.

Recommendation: Engage Aon Custody Advisory Services to conduct a securities finance review and optimization with the intent of improving the revenue generation of the

program by, among other things, migrating to a modestly less risk-averse securities lending collateral pool if prudent.

A motion was made by Trustee Tambe, seconded by another Trustee, to engage Aon Custody Advisory Services, as recommended by staff. The motion carried 8-0-0-1 with voting as follows:

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

B. Review of Parametric Equity Insurance Risk Premium (EIRP) Strategy

Mr. Failor reviewed the background and history of the EIRP strategy managed by Parametric. The strategy is run as an “overlay” strategy and sells both S&P 500 puts and calls to effectively provide market insurance. Given that it was funded as an overlay account, any positive performance would be accretive to total Plan performance. Mr. Failor explained that based on history prior to SCERA’s account inception (both simulated and live), we expected some periods of negative performance, when the market proved to be more volatile than implied by option pricing. These periods, however, were expected to be relatively infrequent and followed by profitable periods which would more than make-up for the prior losses, however these negative performance periods have been more frequent and pronounced than estimated, and the following periods of positive performance have not dominated. The result has been a 5.5 year account history with a small negative return since inception gross-of-fees. While staff believes the strategy should add value over the long-run in a rational market, the unexpected pattern of performance has shaken their confidence over the foreseeable future. As a result, staff recommended discontinuation of the account.

Recommendation: Discontinue the Parametric EIRP (“Defensive Equity”) strategy, given poor performance and uncertainty regarding the strategy’s ability to deliver long-term reliable and meaningfully positive performance.

A motion was made by Trustee Tambe, seconded by Trustee Williamson, to discontinue the Parametric EIRP strategy. The motion carried 8-0-0-1 with voting as follows:

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

C. GTA Babelfish 3rd Quarter Equity Trade Cost Analysis

Mr. Failor provided a brief update, noting that no concerns arose pertaining to trading costs over the quarter. All three separate account equity managers being measured had brokerage commissions below the universe average though the market impact, as measured, was a few basis points higher. This was not of concern as all of the managers have added significant value, net of all trading costs, over the trailing year and since inception.

D. Annual Review of the Aon Consulting Contract – consideration of extension

Mr. Failor provided a summary of the Aon consulting contract, as well as the services provided and other developments for the Board's review to consider, as Aon's current contract covers 3 years beginning in January 2019 with two optional 1-year extensions. Extending the contract through 2023 would use the second and last extension on the current contract. Staff and the Board were satisfied with the consulting service provided and the Trustees were supportive of exercising the extension through the new year.

E. 2022 and 2023 On-Site Due Diligence Meeting Schedule

An upcoming trip to New York, Connecticut, and New Jersey is scheduled for the week following Thanksgiving and three trips are planned for 2023. In addition, UBS AgriVest confirmed the April shareholders meeting in Sonoma, CA.

F. Cash Raise and Cash Planning

Investment Officer Mickey Nguyen outlined the current cash level of the Plan and a planned cash raise for December to cover the Plan's cash needs over the following four months. As of November 14th, total Plan cash available (uncommitted) was a little over \$45M. This balance is sufficient to cover approximately 3 months of expenses.

There are also anticipated cash receipts from winding down the Davidson Kempner funds and the ongoing redemption request from the JP Morgan Strategic Property Fund. However, due to the highly uncertain timing and size of these cash sources, they are not

incorporated as offsets in near-term cash planning. Short-term cash requirements included monthly retiree payroll, manager fees, the 2023 SCERA staff operating expenses, which are transferred to the County in December, and a portion of the remaining capital commitments of \$47M for the KKR infrastructure fund and \$118M for the Fiera Comox farmland fund. Manager guidance suggests the entirety of these remaining capital commitments will be called over the next year. The planned cash raise will withdraw \$50 million from managers plus another \$20 million from the Parametric EIRP account margin which will become available after discontinuation of the account, as decided earlier in the meeting. The cash raise will withdraw funds from Jacobs Levy, Systematic, Dodge & Cox and the State Street Global Markets global equity interim account. Real Assets are overweight versus policy and both stocks and bonds are underweight. Given the illiquidity of Real Assets and the relatively light underweight to stocks, equity managers are being targeted for trimming.

Mr. Failor also recommended a redemption request of \$30M for the UBS Farmland Fund to move toward the eventual goal of equally weighting the two farmland funds at \$125M each based on current valuations. The Board was supportive of this plan. At this time, staff did not expect to receive these funds in the near-term so they were not included in planning for the cash raise.

V. COMMUNICATIONS

- A. SCERA Investment Performance Reports, September and October 2022. Given the earlier date of the November Investment Committee meeting, because of the Thanksgiving holiday, the monthly performance report for October was not yet available. As a result, Mr. Failor provided the October performance results verbally. The Plan's YTD total return was -8.2% versus a target policy return of -13.3%.
- B. FUNDfire, "OCIO Watchdog Calls Out California Pension for Custom Benchmark", October 31, 2022.
- C. Business Insider, "China is blowing up its own economy . . .", October 30, 2022.
- D. WSJ, "China's Xi Jinping, Secure in Power, Faces Deepening Economic Challenges", October 24, 2022.
- E. The Economist, "The EU is strengthening democracy in eastern Europe", Oct. 26, 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 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 scheduled for Thursday, January 26, 2023, at 8:30 a.m. via WebEx. Planned topics for this meeting include a presentation by PIMCO.

IX. ADJOURNMENT

With no further business to conduct, the meeting adjourned at 11:36 a.m.

X. APPROVAL

The above minutes from the November 17, 2022, Investment Committee meeting were approved at the Investment Committee meeting on January 26, 2023.

GREG JAHN, CHAIR