

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

Thursday, June 29, 2023

8:34 a.m.

Presiding: Greg Jahn, Chair

Present: Trustees Neil Baker (Alternate Retiree), Amos Eaton, Erick Roeser (Vice Chair), Joe Tambe, Tim Tuscany, and Bob Williamson; Chief Investment Officer Jim Failor, Investment Officer Mickey Nguyen, Finance and Retiree Services Manager Cheryl Enold, Retirement Analyst Rebecca Gay, and Administrative Aide Julia Smith; Chris Behrns (of Aon); Leigh Ann Poggio and Brian McAuliff (of Guggenheim)

Present via

Zoom: Trustee Travis Balzarini; Eric Denny (of Aon)

Absent: Trustees Chris Coursey and Brian Williams

Public comments were solicited prior to the meeting by emailing [Rebecca.Gay@sonoma-county.org](mailto: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.

Trustee Travis Balzarini requested an emergency exception, under California law AB 2449, to his in-person attendance at the June Investment Committee meeting. He indicated that he had a medical emergency involving an immediate family member that he needed to attend to.

A motion was made by Trustee Williamson, seconded by Trustee Tambe, to grant Trustee Balzarini's request to attend the June Investment Committee meeting via teleconference. The motion carried 6-0-1-2 with roll call voting as follows:

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

I. MINUTES APPROVAL

Approval of the May 25, 2023, Investment Committee meeting minutes.

**Recommendation:** Approve the May 25, 2023, Investment Committee Minutes.

Trustee Balzarini noted typos to the motion on item III C of the minutes. After correction is made to the motion of the Arrowstreet fund, the Committee accepted the official minutes. Committee members that were not in attendance at the May 25, 2023, meeting opted to abstain from voting on this matter.

A motion was made by Trustee Balzarini, seconded by Trustee Roeser, to approve the May 25, 2023, Investment Committee meeting minutes. The motion carried 4-0-3-2 with roll call voting as follows:

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

## II. PRESENTATIONS

- A. Guggenheim – Relationship Manager Leigh Ann Poggio and Junior Portfolio Manager Brian McAuliff provided an organizational update, commented on the fixed income markets, and reviewed the performance and positioning of the bank loan portfolio the firm manages for SCERA. Ms. Poggio gave an overview of the firm describing the 55% employee ownership, \$100 million in asset flows year-to-date in bank loans which now total \$20 billion under management, and \$1 billion of new inflows most notably in the Core Plus strategy. Additionally, she emphasized the consistency in the investment process since CIO Scott Miner's passing, with an Investment Committee which has worked together for 12 years. With no plans to name a new Global CIO for Guggenheim Partners, the firm expects to have less presence in the media going forward.

Mr. McAuliff, who joined the team a year ago from BlackRock, pointed out that bank loans were the bright spot in a challenging 2022 for most asset classes. SCERA's portfolio returned 0.09% gross of fees last year, positive on a relative basis as well. Spread levels are pricing in a 8% default rate versus the 0.7% actual rate at year end. While Guggenheim expects defaults to increase they view the market as overly pessimistic. They see the best opportunities as being in B and CCC rated loans due to credit spreads that are above their 75<sup>th</sup> percentile. Market technicals also are positive for loans. Mr. McAuliff detailed how loans were transitioning from a LIBOR reference rate to SOFR as LIBOR will cease to be published after June 30, 2023. He also covered loan market fundamentals which remain strong historically measured by leverage and interest coverage ratios.

Guggenheim is focused on credit selection and tries to find mispriced loans from companies that exhibit strong metrics operationally. The loan market overall, since it has grown to over a trillion dollars, has shifted to covenant-light credit documents and this has not changed despite the expectations for a possible recession. However, the first lien holdings, which comprise Guggenheim's portfolio, remain in a good position despite this shift. CIO Jim Failor noted that the Guggenheim bank loan strategy has provided strong inflation protection over the recent period but questioned the long-term strategic role for a pension plan with a long time horizon.

- B. Annual Manager Evaluation Report and Risk Budgeting Analysis – Senior Consultant Chris Behrns of Aon Investments presented. Mr. Behrns suggested that the manager evaluation report represents a good comprehensive reference guide, with a current assessment by Aon of the confidence they have in each manager. He highlighted the recent rating change for the UBS AgriVest Farmland Fund being downgraded from Buy to Qualified primarily due to not delivering on performance objectives. CIO Failor commented that staff continues to view this fund as Buy rated on a risk-adjusted basis. UBS runs a low risk strategy that emphasizes down-side protection and has delivered healthy stable returns though they have trailed their benchmark. Other differences in viewpoints on equity managers are not new and relate to Aon's emphasis on business risk (succession planning and AUM volatility). Mr. Behrns provided an update on the rating for PIMCO's core plus strategy which is employed for the SCERA account. PIMCO had been In-Review for several weeks but was downgraded to Qualified as of the morning of this meeting. Aon's Flash Report noted that PIMCO's management has failed to deliver on stated goals and certain key portfolio managers lack experience in some areas. In particular, their top-down positioning has not been adding value while their bottom-up security selection has shown good results. It was also noted that PIMCO's fees remain at the high end of the range for comparable managers.

After defining the sources of risk (alpha and beta) as an introduction to the Risk Budgeting and Style Analysis report, Mr. Behrns summarized the Total Plan Risk profile and pointed out that the 10.7 beta risk and 11.0 total risk results are good, in that our active management in total is adding only a modest level of additional risk, is in-line with our peers and is similar to the results of the past decade. He did acknowledge that the risk budgeting analysis is better for analyzing the risk of the public markets due to the smoothing and lagged effect of private market valuations.

- C. Educational Presentation on Private Debt – Aon Investments Associate Partner Eric Denny presented. It was noted that Aon is developing an internal "Private Credit SWAT" team from different resources within the firm because the private debt space encompasses such a wide-ranging area of opportunity and expertise. A key factor to assess when considering a Private Credit (PC) investment is the origination skills of the manager.

Some characteristics of PC include low correlation to bonds resulting from their floating rate structure and downside protection from contract covenants. Even though PC has grown substantially since the Great Financial Crisis (GFC), PC only represents 1.6% of the total investable capital market. Although returns have declined down since the GFC from growing competition, rates are also higher than before. Mr. Denny stated he was not concerned by the increase in PC capital raising and believes there is a narrower set of skilled managers that can originate well. In response to a question regarding benchmarks, he commented that, depending on the underlying strategy, the Credit Suisse Leveraged Loan Index, the High Yield Loan Index, the HFRI Distressed Index or public fixed income indices are generally utilized. Most managers use a third-party valuation company on a quarterly basis in conjunction with an internal monitoring team, advisory board for oversight and auditors to handle the process of valuations. Mr. Denny covered the 5-10 year lifecycle of a typical PC investment, importance of current income stream, 200-400 bps illiquidity premium over public fixed income, other strategies under "Hybrid Financing" and sub-strategies under PC, including opportunistic credit strategies.

Management fees are in the range of 0.50-1.5% and performance fees are 10-20% on returns over a 5-8% hurdle rate. It is likely fees will see compression with a slightly smaller carry structure. The vast majority of funds have closed-end structures. Mr. Denny noted only a limited set of Aon-Buy-rated funds are currently open. Regarding liquidity, investors should expect 7-10 years plus an extension period. LPs have fewer rights in a closed-end fund, although larger separately managed accounts can negotiate agreements that are more investor friendly. For open-end funds, investors have an annual or semiannual exit opportunity. Investors are then cashed-out as loans reach maturity. Returns for private credit have been strong and consistent and over 1, 3, 5, and 10 year periods surpassed bank loan performance.

In response to concerns about the impact of potentially declining interest rates next year, Mr. Denny believes PC should stay attractive regardless of the rate environment due to contractual mechanisms establishing 3-4% "floors" to protect from falling rates. He also noted that PC managers are already broadly diversified with their underlying loans so even with a \$100-150 million account size, a well-diversified portfolio can be achieved with 2 to 4 investment managers.

### III. INVESTMENT STAFF AND CONSULTANT

- A. Annual Alternative Investment Fee and Expense Disclosure, 2022 – per Government Code section 7514.7.

CIO Jim Failor announced the 7514.7 reporting requirement was reassessed by legal staff and the updated interpretation is that the open-end Real Estate and Farmland funds should

also be included in this annual disclosure. It was noted that whether an investment is considered "in scope" for this law depends on both the nature of the investment and the investment vehicle and, as a result, is somewhat complex. Beginning with the 2022 reports, the requisite fee and expense data is being reported for all of SCERA's Infrastructure, Real Estate and Farmland managers. CIO Failor noted that expenses born by these funds have not raised concerns and are generally in the range of 10-20 basis points.

B. Triennial Review and Updates to SCERA's Investment Policy Statement

**Recommendation:** Approve draft Investment Policy Statement as presented.

Trustee Eaton requested the Committee move consideration of this item to the July Investment Committee meeting as there were a number of changes to be reviewed. The Trustees agreed to the deferral.

C. Discussion Regarding the 2023 Planning Session Agenda

CIO Jim Failor solicited suggestions from Trustees for October's Planning Session. There was a discussion regarding the asset class panel format. It was agreed to keep the panel format as it is a good forum to hear from all of SCERA's managers, but staff will make adjustments to shorten their length. Demographics was mentioned as remaining a topic of high interest. Trustees suggested requesting the presenter's use larger fonts on their slide presentations so they can be more easily read from the back of the audience.

IV. COMMUNICATIONS

A. SCERA Investment Performance Report for May 2023.

Investment Officer Mickey Nguyen announced the total plan performance for May was -0.94%, which was better than the target policy return by 12 bps. Year-to-date (YTD) however the plan was up 3.6% which is lagging the policy target by 62 bps. Contributing to underperformance YTD versus the target policy return was Jacobs Levy (over -340 bps YTD relative underperformance) and Dodge & Cox (over -500 bps YTD relative underperformance). US Equity performance has been extremely bifurcated this year. Up until June, small caps have been flat for the year, while large caps were closing in on double digit gains. But digging deeper into those gains, only 7-8 technology stocks contributed almost all the upside. Excluding the impact from those "AI" themed stocks, the S&P500 would have been in slight negative territory. Such a narrow market is tough for active managers, but June's continued equity rally has broadened significantly, so we expect better mid-year relative performance results from our equity managers.

Outperformance highlights include strong benchmark-relative performance by Arrowstreet in May and YTD as well as SSGA's non-US and global index strategies which have outperformed due to SCERA's Rule Of Law (ROL) guideline which excluded, most notably, China which is now over 7% of the ex-US benchmark.

- B. IFM Investor Update, "IFM appoints new Board Chair, . . .", June 21, 2023.
- C. UBS Real Estate US Update, "Organizational changes to the Real Estate US team", June 2023.
- D. Bloomberg, "AI Is Becoming the Stock Market's Answer to Everything", May 26, 2023.
- E. The Economist, "Investors must prepare for sustained higher inflation", June 22, 2023.

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.

There were no general discussion matters.

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, July 27, 2023, at 8:30 a.m. Planned topics for this meeting include a presentation by Fiera Comox. 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.

Chair Jahn reported he will be out of town on July 27, 2023, and will miss the meeting; alerting Vice Chair Roeser of his need to Chair.

VIII. ADJOURNMENT

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

IX. APPROVAL

The above minutes from the June 29, 2023, Investment Committee meeting were approved at the Investment Committee meeting on July 27, 2023.

ERICK ROESER, VICE CHAIR