# VENTURA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

# BOARD OF RETIREMENT

# BOARD RETREAT

# OCTOBER 11, 2007

## MINUTES

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| **DIRECTORS PRESENT:** | Tracy Towner, Chair, Safety Employee Member<br>William W. Wilson, Vice Chair, Public Member<br>Lawrence L. Matheney, Treasurer, Ex-officio Member<br>Albert G. Harris, Public Member<br>Joseph Henderson, Public Member<br>Karen Becker, General Employee Member<br>Robert Hansen, General Employee Member<br>Arthur E. Goulet, Retiree Member<br>Chris Johnston, Alternate Employee Member<br>Will Hoag, Alternate Retiree Member |
| **DIRECTORS ABSENT:** | Peter C. Foy, Public Member |
| **STAFF PRESENT:** | Tim Thonis, Retirement Administrator<br>Walter Lauzon, Chief Financial Officer<br>Lori Nemiroff, Assistant County Counsel |
| **PLACE:** | Embassy Suites Hotel<br>Mandalay Beach Resort<br>2101 Mandalay Beach Road<br>Oxnard, CA 93035 |

**ITEM:** **TOPIC:**

I. **Review of Agenda** – Tracy Towner, Chairman

Chairman Towner called the Board Retreat to order at 9:00a.m.

II. **Manager Structure Risk Modeling Exercise**

Kevin Vandolder and Daniel Pawlish from EnnisKnupp were present to lead the Risk Modeling Exercise.

Mr. Vandolder summarized VCERA's current investment risk profiles for the total fund, for the domestic equity allocation and for non US equity allocation. Mr.

## II. Manager Structure Risk Modeling Exercise (continued)

Vandolder stated that the goal was to maximize the excess return received from active management over the additional risk the active manager assumed relative to the benchmark. Mr. Vandolder noted that this measure of excess return relative to risk is referred to as the information ratio.

Mr. Vandolder and Mr. Pawlish lead the Board through different scenarios where funding levels among VCERA's investment managers and asset allocations were changed in order to demonstrate how the information ratio was impacted by the changes.

## III. Review of Opportunistic Search

Mr. Vandolder reviewed the upcoming discussions on the 130:30 mandate by summarizing the investment processes followed by the firms, why academic research supported the processes, how broader investment mandates can lead to success and why early adopters of these types of strategies typically have a greater degree of long-term success.

Mr. Vandolder discussed the distinguishing characteristics of the three firms, Goldman Sachs Asset Management, Acadian Asset Management and UBS Global Asset Management that the Board would hear presentations from later in the morning.

## IV. Goldman Sachs 135/35

Michael Keough and Tom Dempsey were present from Goldman Sachs Asset Management (Goldman Sachs) to discuss the 135:35 Core Global Flex Fund.

Mr. Keough summarized Goldman Sachs' organization noting that the 135:35 Core Global Flex Fund was an extension of their organization's success in "long only" strategies and having flexibility in shorting stocks provides Goldman Sachs with the opportunity to achieve more alpha at higher risk levels. Mr. Keough stated that additional alpha can be achieved through this process because "shorting" allows Goldman Sachs' investment managers to better express their negative views, short sales allow their managers to hedge exposure to higher alpha stocks, which allows larger overweight positions and proceeds from short sales fund additional purchases to maintain a target beta of 1.0.

Mr. Dempsey provided an explanation regarding the impact on the Goldman Sachs Flex Fund from the liquidity crisis in August. Mr. Dempsey noted how multi-strategy hedge funds were impacted during the crisis and were forced to sell investment grade fixed income instruments and equity positions in order to meet capital calls. According to Mr. Dempsey, the sell-off frequently involved the

## IV. Goldman Sachs 135/35 (continued)

same names and it became a global event, which could be best summarized as a panic. Mr. Dempsey argued that the sell-off was not based upon true market fundamentals and resulted in leverage being reduced to more acceptable levels.

Mr. Dempsey summarized the themes of Goldman Sachs' investment process that focused on profitability, earnings quality, and management impacts.

Mr. Dempsey also described how Goldman Sachs weighted the factors utilized within its quantitative process, the prime broker relationships it utilizes in shorting stocks, and product performance and fee structure.

## V. Acadian 130/30

Jack Gastler and Brendon Bradley were present from Acadian Asset Management to discuss their 130:30 quantitative based strategy.

Mr. Gastler summarized Acadian Asset Management's (Acadian) organization, investment philosophy and representative client list. Mr. Gastler remarked on the stability of the organization, how Acadian focused on the broad universe to maximize opportunities and its multi-factor analysis.

Mr. Bradley provided an overview of the 130:30 process at Acadian focusing on the ranking of 25,000 stock in Acadian's investment universe, how forecasts are accomplished, portfolios constructed and Acadian's focus on cost-effective trading.

Mr. Bradley also remarked on how Acadian "shorts" stocks in the portfolio, the depth of Prime Broker relationships that currently exist and how Acadian gauges the capacity and depth of the "short selling" market. Mr. Bradley also explained how information ratios could be increased by utilizing 130:30 investment strategies.

Mr. Gastler described the investment structures for the 130:30 process, minimum account sizes and the fee structure.

Mr. Vandolder and Mr. Goulet expressed concerns regarding the performance fee arrangement and questioned whether a limit could be placed on the performance fee arrangement.

## VI. UBS Fundamental 130/30

Scott Hazen and Elizabeth Sanders were present from UBS Asset Management to discuss the UBS U.S. Equity 130:30 strategy.

## VI. UBS Fundamental 130/30 (continued)

Ms. Sanders discussed how UBS Asset Management (UBS) offered a fundamental based approach that differed from the quantitative approach typically seen when discussing 130:30 strategies, had a deep and experienced investment team, proven 25 year process of identifying overvalued and undervalued securities and an investment process that consistently added value over time.

Mr. Hazen discussed how UBS investment analysts established a ratio of "price to intrinsic value" based upon a discounted free cash flow analysis for targeted securities. The securities are then ranked in quintiles based upon the most underpriced (attractive) and overpriced (unattractive) resulting from the price to intrinsic value analysis. The portfolio then is constructed from the rankings with approximately 30-50 stocks being held "short" and 50-70 stocks held "long". The typical UBS 130:30 portfolio will have a range of 120%-140% of stocks being held "long" with 20%-40% being held "short".

Mr. Hazen and Ms. Sanders provided further information on the fee structure and performance for the UBS 130:30 investment strategy.

*Board adjourned for lunch at 12:15pm and returned at 1:15pm.*

## VII. Revisiting the Merits of Cash Equitization

Upon returning from lunch, the Board held discussions regarding the merits of funding a 130:30 mandate.

Mr. Vandolder noted that EnnisKnupp believed that appropriate level of equity assets held in international strategies should be approximately 50% of a fund's total equity allocation. Mr. Vandolder offered, by utilizing the Risk Model, several funding alternatives for the Board to consider.

Mr. Wilson moved, seconded by Mr. Hansen, to select Acadian Asset Management to manage a 130:30 global investment mandate with a funding level of $100 million, subject to contract approval and further discussions to limit the amount of performance based fees. Funding for the mandate to come from the current global and domestic equity allocations. Additionally, the Board will continue to examine the role of specialized investment mandates within the domestic equity allocation and will consider increasing VCERA's international equity allocation when the opportunities become available.

## VII. Revisiting the Merits of Cash Equitization (continued)

Motion Passed.

Mr. Vandolder provided a brief overview of cash equitization programs and why such a program would be beneficial to VCERA.

## VIII. State Street

Anne Heaphy, Megan Hart and Mike Martel were present from State Street Global Advisors to discuss State Street Global Advisor's cash equitization program.

Ms. Heaphy and Ms. Hart advised the Board that State Street Global Advisors (SSGA) had been providing cash equitization services since 1983. Most approaches in the area of cash equitization were based upon customized approaches and the level of customization was dependent upon the size and volume of the investment program. According to Ms. Hart, SSGA was currently providing cash equitization services to the Sacramento and Fresno County retirement systems.

Mr. Martel described the various ways that SSGA could provide for cash equitization including a balanced fund solution, index fund solution and by utilizing futures contracts to equitize administrative cash for one asset class. According to Mr. Martel, if VCERA's cash underperforms by 4% in any year, and based upon cash being approximately 2% of plan assets, then VCERA has the potential to lose $2.5 million per year. Mr. Martel also described how SSGA would work with VCERA's custodian in executing a cash equitization program.

## IX. Clifton

Ben Lazarus and Rick Ballsrud were present from the Clifton Group to describe their cash securitization process.

Mr. Lazarus provided background on the Clifton Group's (Clifton) organization and noted that Clifton began utilizing derivative strategies to assist clients in this area in 1986. Mr. Lazarus noted that 24% of Clifton was owned by its employees with the balance held by an outside firm. Presently, Clifton managed $16.5 billion in assets.

Mr. Lazarus summarized how cash equitization programs allowed funds to earn stock and bond type returns on cash thereby resulting in reduced performance risk and increased operating efficiencies along with an opportunity to enhance returns.

## IX. Clifton (continued)

Mr. Ballsrud provided insight on Clifton's process and how funds could replicate S&P 500 stock returns utilizing futures. Mr. Lazarus and Mr. Ballsrud offered scenarios utilizing VCERA's actual data to describe the benefits that may be obtained by utilizing the strategy and illustrated how Clifton would manage the program on a daily basis.

Mr. Lazarus described the fee structure and the merits of utilizing Clifton.

## X. Review of Asset Trust Construct

Mr. Vandolder provided a review of BGI"s Asset Trust Construct.

## XI. BGI

Jason Strauth from Barclays Global Investors (BGI) was present to provide a review of the Asset Trust Construct.

Mr. Strauth described the process illustrating the role of the preferred or beta investor (VCERA) and the ordinary investor (another institutional investor). Mr. Strauth provided an example on how a trust may be constructed and reviewed how the collateralization requirements of the trust were administered. Mr. Strauth described the benefit to a preferred investor as being a guaranteed return of 10 basis points over the S&P 500 with no management fee charged on the assets held with the trust.

## XII. Board Member and Non-Board Member Comment and Reaction – Tracy Towner

The Board held discussion regarding the merit of a cash equitization program with Mr. Goulet offering positive comments on the Clifton Group's approach. Staff was directed to return with a recommendation on a cash equitization manager at the November business meeting.

Discussion was also held regarding the risks and benefits of participating in BGI's Asset Trust strategy.

Mr. Matheney moved, seconded by Mr. Henderson, to direct staff not to return with a recommendation regarding the Asset Trust Construct.

Motion Passed.

## XIII. ADJOURNMENT

There being no further items of business before the Board, Chairman Towner adjourned the retreat at 3:50 p.m.

Respectfully submitted,

TIM THONIS, Administrator

Approved,

TRACY TOWNER, Chair