

BOARD OF INVESTMENTS MINUTES 7-28-10

PRESENT

- Herman Santos, Chair
- John M. Barger, Vice Chair
- Diane Sandoval, Secretary
- Simon S. Russin
- Mark J. Saladino
- Michael Schneider
- Leonard Unger
- Estevan Valenzuela

ABSENT

- William Pryor

STAFF, ADVISORS, PARTICIPANTS

- Gregg Rademacher, Chief Executive Officer
- Robert Hill, Assistant Executive Officer
- Janice Golden, Assistant Executive Officer
- Lisa Mazzocco, Chief Investment Officer
- John McClelland, CRE, Principal Investment Officer, Real Estate
- Vache Mahseredjian, CFA, Principal Investment Officer
- Juan Almaguer, Principal Investment Officer
- Christopher J. Wagner, Senior Investment Officer, Private Equity
- June H. Kim, Senior Investment Officer, Equities
- Robert Z. Santos, Investment Officer, Fixed Income
- Gerald P. Flintoft, CAIA, Investment Officer, Private Equity
- Esmeralda Vita del Bosque, Senior Investment Analyst, Equities
- Dale Johnson, Senior Investment Analyst
- Robb Van Der Volgen, Chief Counsel
- Earl W. Buehner, Senior Staff Counsel
- Johanna Fontenot, Senior Staff Counsel
- Michael D. Herrera, Senior Staff Counsel
- Christine Roseland, Staff Counsel
- Cynthia Lau, Legislative Analyst

1. APPROVAL OF THE MINUTES

1. APPROVAL OF THE MINUTES OF THE SPECIAL MEETING OF THE BOARD OF INVESTMENTS OF MAY 26, 2010.

A motion was made by Mr. Unger, seconded by Ms. Sandoval, to approve the Minutes of the Special Meeting of the Board of Investments of May 26, 2010. The motion carried by unanimous vote.

2. APPROVAL OF THE MINUTES OF THE MEETING OF THE BOARD OF INVESTMENTS OF JUNE 9, 2010. A motion was made by Mr. Russin, seconded by Ms. Sandoval, to approve the Minutes of the meeting of the Board of Investments of June 9, 2010. The motion carried with Mr. Unger abstaining.

3. APPROVAL OF THE MINUTES OF THE SPECIAL MEETING OF THE BOARD OF INVESTMENTS OF JULY 14, 2010. A motion was made by Mr. Unger, seconded by Mr. Russin, to approve the Minutes of the Special Meeting of the Board of Investments of July 14, 2010. The motion carried with Ms. Sandoval abstaining.

2. PUBLIC COMMENT

None.

3. REPORT ON CLOSED SESSION ITEMS

None.

4. IV. ACTION ITEMS

1. Recommendation as submitted by Gregg Rademacher, Chief Executive Officer: Approve attendance of Board members, and staff as designated by the Chief Executive Officer, at IREI's VIP Asia Investor Roundtable to be held on September 15-17, 2010, at the Four Seasons Hotel in Singapore; and approve reimbursement of all travel costs incurred in accordance with LACERA's Education and Travel Policy. (Memo dated July 21, 2010.) (Placed on the Agenda at the request of Mr. Barger.)

A motion was made by Mr. Valenzuela, seconded by Mr. Russin to approve the recommendation as amended to include "approve reimburse-ment of all costs incurred in accordance with LACERA's Education and Travel Policy. The motion carried by unanimous vote.

2. Recommendation as submitted by Gregg Rademacher, Chief Executive Officer: Approve attendance of Board members, and staff as designated by the Chief Executive Officer, to the World Pension Forum to be held at the Nassau Inn, Princeton, New Jersey on September 13-15, 2010; and approve reimbursement of all travel costs incurred in accordance with LACERA's Education and Travel Policy. (Memo dated July 23, 2010.) (Placed on the Agenda at the request of Mr. Santos.)

A motion to approve the recommendation was made by Mr. Saladino, seconded by Ms. Sandoval. The motion carried by unanimous vote.

3. Recommendation as submitted by John McClelland, Principal Investment Officer, Real Estate and James Rice, CFA, Investment Officer: Authorize Staff to modify the Real Estate Strategic Plan to include investment in commercial real estate debt. (Memo dated July 20, 2010.)

Mr. McClelland reported that the proposed modification to the real estate strategic plan would allow investing a portion of the real estate portfolio in real estate debt. He views this area as a potential opportunity that deserves serious consideration. Institutional investors typically divide the universe of opportunities into debt or equity, and then further divide debt and equity into public or private sectors. These four areas are often referred to in the industry as the four quadrants. LACERA's real estate program has traditionally focused on the private equity side of the quadrant. The focus of the recommendation is the private debt quadrant. LACERA has no exposure to this quadrant and there may be attractive opportunities for investment. One of the reasons is that there are unmet needs for new loans. Property owners and lenders are currently faced with a need to re-capitalize what have become over-leveraged properties, resulting from a decline of approximately 40% in the underlying value of real estate in the last several years. Much of the market is not transacting, since the owners of the 40% reduced value property are reluctant to trade at the depressed prices. However, there is an enormous wave of loans that were initiated in the 2004 to 2007 era. These loans are moving into the maturity stage, since most of them are five year loans. There is an estimated \$1 trillion of maturities expected during the period between now and 2014, setting the stage for enormous opportunity that is currently not being met by the lenders in the market place. Mr. McClelland also provided sample capital structures for a real estate investment.

Real estate debt investments have a number of different factors that impact attractiveness to lenders and borrowers. The risks and returns of private debt investments vary from traditional unlevered or low-levered real estate equity investments, LACERA's typical investments in the Real Estate Asset Class. In general, debt investments have lower risk and less upside potential, if any, than equity investments in real estate. Debt investing is also less risky than equity investing because nearly all of the expected return comes from current payments on the loan. (A small amount of return would likely be derived from origination fees paid by the borrower.) Conversely, equity investments only get a portion of the return from current cash flow with the remainder coming from value appreciation. The appreciation component of return to an equity holder is much less certain than debt service return of a mortgage holder. A brief discussion followed on fee structure issues and co-mingled opportunities.

A motion to approve the recommendation was made by Mr. Unger, seconded by Mr. Valenzuela. The motion carried by unanimous vote.

4. Recommendation as submitted by Vache Mahseredjian, Principal Investment Officer and Juan M. Almaguer, Principal Investment Officer: Modify the investment guidelines for LACERA's cash portfolio as summarized. (Memo dated July 21, 2010.)

Mr. Mahseredjian presented the proposed modification of the investment guidelines for LACERA's cash portfolio. He reported that it was appropriate to review the portfolio's risk return parameters to consider how much risk a cash portfolio should be exposed to, how much liquidity it needs, the trade-offs between risk and return, liquidity and the role of cash in the larger LACERA portfolio.

He summarized the portfolio's structure, its sources of cash and its historical market value. The long term performance has been very good, but performance over the past three years has been mixed and volatile. The focus is not about past returns, but about risks in the future.

An alternative way of reducing the cash account risk and enhancing its liquidity is to tighten the investment guidelines while maintaining the existing structure. Specifically, staff recommends tightening guidelines that limit the exposures most responsible for the portfolio's high volatility over the last 2 years. The suggested guidelines would reduce the maximum exposure to non-government sectors from 25% to 10%; reduce the maximum exposure to individual issuers from 2% to 0.75%; and raise the minimum credit rating requirement from BBB to A-. These proposed guidelines are expected to reduce the portfolio's projected tracking error from its current level of 1.2%, to a range of .5% - 1%. If these guidelines had been in place during the extreme environment of 2008, the underperformance would have been limited to 2% instead of the actual 5.15%. The portfolio currently has a 1.80% yield advantage over its benchmark. Therefore, it is expected to outperform by a significant margin in the near term. Over the long term, however, as that yield advantage declines, the portfolio's excess return expectation will decrease.

These changes are anticipated to result in lower risk and lower expected return than the current portfolio, yet provide sufficient margin to continue outperforming a money market alternative. The changes will also improve the current portfolio's diversification and liquidity. A brief discussion followed.

A motion to approve the recommendation was made by Mr. Barger, seconded by Ms. Sandoval. The motion carried by unanimous vote.

5. REPORTS

1. Oaktree Capital Management Review
Post Advisory Group Review

- Vache Mahseredjian, Principal Investment Officer
- Robert Z. Santos, Investment Officer, Fixed Income

(Memo dated July 13, 2010.)

1. Oaktree Capital Management

- Howard Marks, Chairman
- Regan Scott, Managing Director and Co-Director of Research
- Tony Harrington, Managing Director, Head of Marketing

Robert Santos provided a brief overview of Oaktree Capital Management's ("Oaktree") performance. He reported that Oaktree's personnel would make a formal presentation to the Board as required by LACERA's Manager Monitoring and Review Policy. He introduced the principals of Oaktree and they followed with a review of the portfolio.

Oaktree is based in Los Angeles and was founded in April 1995. Their high yield investment team is comprised of 23 research analysts with senior members of the team possessing more than 15 years of experience. Oaktree's defensive high yield fixed income strategy aims to produce above average returns and limit risk in down markets. They employ a credit-intensive strategy that does not reach for yield by buying risky issues, such as distressed debt or convertible bonds.

It was reported that year-to-date Oaktree lagged the Barclays Capital High Yield Ba/B Index by 48bps, but outpaced the index by 127 bps for the one-year period, net of fees. Since the account's inception, the portfolio has outperformed by 64 bps annualized, net-of-fees, surpassing the account's excess return target of 30 to 50 bps. The portfolio underperformed by 246 bps in the second quarter of 2009. Financials rebounded strongly in 2009, snapping back from their dismal performance in 2008. Excluding financials, they meaningfully outperformed the benchmark between the twelve months ending September 30, 2009 through March 31, 2010.

A brief discussion followed and the Report was received and filed.

2. Post Advisory Group

- Larry Post, Vice Chairman and Portfolio Manager
- Allan Schweitzer, CIO, Senior Portfolio Manager
- Ralph Canada, Managing Director, Marketing

Post Advisory Group ("Post") is based in Los Angeles. They began managing a high yield fixed income mandate for LACERA in January 2002 as part of LACERA's Fixed Income Emerging Manager Program. In March of 2003 they were awarded a full high yield mandate. Their high yield investment team is comprised of three portfolio managers and 14 research analysts. Post's investment philosophy emphasizes downside protection with a primary focus on controlling credit risk, default risk, and liquidity risk.

To manage liquidity risk Post limits potential investment to those securities with an original issue value of more than \$100 million. Year-to-date (as of May 31, 2010), Post lagged the Barclays Capital High Yield Ba/B Index by 36 bps, and underperformed the index by 260 bps for the one-year period, net-of-fees. Since the account's inception, the portfolio has outperformed by 33 bps annualized, net-of-fees, meeting its expected excess return target of 30 to 60 bps. A brief discussion followed and the Report was received and filed.

2. Real Estate Performance Measurement Report 1st Quarter Ended 2010

- John McClelland, Principal Investment Officer, Real Estate

(Memo dated July 20, 2010.) (For information only.)

The Real Estate Performance Measurement Report is for information only and was received and filed.

3. Shamrock Capital Advisors, Inc.

- June Kim, Senior Investment Officer, Equities Dale Johnson, Senior Investment Analyst, Equities

(Memo dated July 7, 2010.) (For information only.) The memoranda on Shamrock Capital Advisors, Inc. is for information only and was received and filed.

4. Chief Executive Officer's Report

- Gregg Rademacher, Chief Executive Officer

(Memo dated July 7, 2010.) (For information only.)

The Chief Executive Officer's Report is for information only and was received and filed.

5. Chief Investment Officer's June 2010 Report

- Lisa Mazzocco, Chief Investment Officer

(Memo dated July 22, 2010.) (For information only.)

The Chief Investment Officer's June 2010 Report is for information only and was received and filed.

6. GOOD OF THE ORDER


(For discussion purposes only.)

Mr. Van Der Volgen reminded the Board of the Brown Act Training to be held immediately following the September 8, 2010 Investment Board meeting. The Board commended Ms. Mazzocco on the July 14, 2010, Board Off-Site meeting.

Green Folder Items

1. Memo dated July 2, 2010 from Michael D. Herrera, Senior Staff Counsel regarding the U.S. Supreme Court Decision in **Merck & Co. v. Reynolds**.
2. Memo dated July 23, 2010, from Michael D. Herrera, Senior Staff Counsel regarding the U.S. Supreme Court Decision in **Free Enterprise Fund, et al. v. Public Company Accounting Oversight Board, et. al.**
3. A copy of the July 2010 International Travel Priority List.

7. ADJOURNMENT

 **PROTECT** | We continue to employ solid investment and business strategies designed to serve the best interests of our members and their beneficiaries.

4/28/11