AGENDA

A REGULAR MEETING OF THE CREDIT & RISK MITIGATION

COMMITTEE

OF THE BOARD OF INVESTMENTS

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CALIFORNIA 91101

*8:00 A.M., WEDNESDAY, SEPTEMBER 12, 2018

The Committee may take action on any item on the agenda,
and agenda items may be taken out of order.

I. CALL TO ORDER

II. APPROVAL OF MINUTES

A. Approval of the Minutes of the Special Meeting of March 5, 2018.

III. PUBLIC COMMENT

IV. CONSENT ITEMS

V. NON-CONSENT ITEMS

A. Recommendation as submitted by James Rice, Principal Investment Officer: That the Committee approve the 2019 Hedge Funds 2019 Investment Plan.
(Memo September 12, 2018)

B. Recommendation as submitted by James Rice, Principal Investment Officer: That the Committee approve the 2019 Hedge Funds Objectives, Policies & Procedures.
(Memo dated September 12, 2018)

C. Recommendation as submitted by Jude Perez, Principal Investment Officer and Ted Wright, Principal Investment Officer: That the Committee approve the Cash Overlay Manager Search Minimum Qualifications and Scope of Work.
(Memo dated September 12, 2018)

VI. REPORT ON STAFF ACTION ITEMS

VII. GOOD OF THE ORDER
(For information purposes only)

VIII. ADJOURNMENT

*The Board of Investments has adopted a policy permitting any member of the Board to attend a standing committee meeting open to the public. Members of the Board of Investments who are not members of the Committee may attend and participate in a meeting of a Committee but may not vote on any matter discussed at the meeting. The only action the Committee may take at the meeting is approval of a recommendation to take further action at a subsequent meeting of the Board.

The Chair of the Board of Investments may appoint alternate voting members if absences result in less than 3 voting members.

Documents subject to public disclosure that relate to an agenda item for an open session of the Board of Investments that are distributed to members of the Board of Investments less than 72 hours prior to the meeting will be available for public inspection at the time they are distributed to a majority of the Board of Investments Members at LACERA's offices at 300 N. Lake Avenue, Suite 820, Pasadena, CA 91101, during normal business hours of 9:00 a.m. to 5:00 p.m. Monday through Friday.

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MINUTES OF THE SPECIAL MEETING OF THE

FIXED INCOME/HEDGE FUNDS/COMMODITIES COMMITTEE

OF THE BOARD OF INVESMENTS*

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CALIFORINA 91101

*8:00 A.M., MONDAY, MARCH 5, 2018

PRESENT: Wayne Moore, Chair

Herman Santos, Vice Chair

Ronald Okum

Joseph Kelly

David Green, Alternate

MEMBERS AT LARGE: Michael Schneider

Shawn Kehoe

Gina Sanchez

David Muir

STAFF, ADVISORS, PARTICIPANTS

Jonathan Grabel, Chief Investment Officer

Vache Mahseredjian, Principal Investment Officer

James Rice, Senior Investment Officer

Meketa Investment Group
Stephen McCourt, Managing Principal

Tim Filla, Vice President

I. CALL TO ORDER

The meeting was called to order at 8:00 a.m., in the Board Room of the Gateway Plaza.

II. APPROVAL OF MINUTES

A. Approval of the Minutes of the Regular Meeting of January 10, 2018.

Mr. Santos made a motion, seconded by Mr. Kelly to approve the minutes of the regular meeting of January 10, 2018. The motion passed unanimously.

III. PUBLIC COMMENT

There were no requests from the public to speak.

IV. CONSENT ITEMS

There were no items to report.

V. NON – CONSENT

A. Recommendation as submitted by James Rice, Senior Investment Officer: That the Committee approve the Fund of Funds Guidelines.
(Memo dated February 22, 2018)

Mr. Kelly made a motion, seconded by Mr. Santos to approve the Hedge Fund of Funds Guidelines. The motion passed unanimously.

B. Recommendation as submitted by Vache Mahseredjian, Principal Investment Officer: That the Committee approve the Cash Program (including Cash Sweep).
(Memo dated February 23, 2018)

Mr. Santos made a motion, seconded by Mr. Green to approve the Cash Program Review (Including Cash Sweep). The motion passed unanimously.

VI. GOOD OF THE ORDER
(For information purposes only)

There was nothing to report.

VII. ADJOURNMENT

There being no further business to come before the Committee, the meeting was adjourned at approximately at 8:20 a.m.

August 31, 2018

TO: Each Member
Credit and Risk Mitigation Committee

FROM: James Rice, CFA
Principal Investment Officer

FOR: September 12, 2018 Credit and Risk Mitigation Committee

SUBJECT: **2019 HEDGE FUNDS ANNUAL INVESTMENT PLAN AND THE OBJECTIVE, POLICIES, AND PROCEDURES**

RECOMMENDATION

1. Advance the 2019 Hedge Funds Annual Investment Plan to the Board of Investments for approval.
2. Advance the 2019 Hedge Funds Objectives, Policies, and Procedures to the Board of Investments for approval.

BACKGROUND

LACERA's Hedge Funds Program ("Program") is governed by LACERA's Investment Policy Statement ("IPS") and two documents: The Hedge Funds Annual Investment Plan ("HFAIP") (**Attachment 1**) and the Hedge Funds Objectives, Policies, and Procedures ("OPP") (**Attachment 2**). Both a redline version with changes from last year and a clean version are attached for each document.

The OPP defines the Program's objectives and its high level parameters, stipulates the detailed policies that govern the Program, establishes the Program's risk management practices, spells out the procedures to be followed, and delineates the responsibilities of the various parties involved.

The HFAIP describes and guides capital planning for investments over the next few years, including direct hedge fund investments. Both the OPP and HFAIP address the Program broadly, but have an emphasis on the addition of a direct portfolio as this component is undergoing the most change.

DISCUSSION

In the HFAIP, the capital investment for 2019 is approximately $985 million to be invested in direct hedge funds. This will bring the Program to 4% of the Total Fund by 4Q 2019, in line with LACERA's asset allocation policy approved in May 2018. There will also be a reduction in allocation to the diversified hedge fund of funds portfolio in 4Q 2019 by $250 million, the amount to be invested into the direct portfolio during that same quarter.

There is an effort underway to streamline and standardize the LACERA level Investment Policy Statement with a separate Procedures document that could include the various OPP's for the private market asset classes. The OPP and HFAIP documents under consideration today have not been modified to reflect any changes in Fund level policies and procedures documents given the time frame these documents are required for approval and the early stage of the LACERA level efforts.

In the OPP and AIP, the documents have been updated to propose the following notable changes:

- The removal of the Credit Hedge Fund of Funds portfolios from the Program. Credit Hedge Fund of Funds will be re-categorized under a new sub-category called Illiquid Credit within a new asset category called Credit.
- Subject to the Board of Investments' approval at the September 12th meeting, updating the Program's benchmark to be in line with the General Consultant's capital market assumptions. The proposed primary benchmark of the Diversified Hedge Fund Program is an annualized return of 250 basis points greater than an index of 3-month United States Treasury bills ("T-bills")[1].
- An updated capital allocation plan regarding building the direct hedge funds portfolio, and eventually moving allocations from the diversified hedge fund of funds to direct hedge funds.
- Consideration of adjustments to the mandates over time of the two diversified hedge fund of fund managers, Grosvenor Capital Management and Goldman Sachs Asset Management, possibly to an emerging manager mandate and/or more targeted hedge fund strategies.
- Consideration of the outstanding search for a hedge fund Consultant.

Elsewhere, in both documents, figures have been updated to reflect current values and a number of phrasing changes are proposed that intend to clarify the language in the documents. The proposed language changes are not intended to materially alter the way the Program is governed.

CONCLUSION

Staff has modified the OPP and the HFAIP, the two documents that will govern the Hedge Fund Program and recommends the Committee advance both of these to the Board for approval.

Attachments

Noted and Reviewed:

Jonathan Grabel
Chief Investment Officer

JR:jr:mm

[1] This benchmark has been 500 basis points greater than an index of 3-month United States Treasury bills ("T-bills") since the inception of the program.

ATTACHMENT 1

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

HEDGE FUNDS

~~2018~~2019 Hedge Funds Annual Investment Plan

~~November 2, 2017~~

September 12, 2018

TABLE OF CONTENTS

INTRODUCTION

The ~~2018~~2019 Hedge Funds Annual Investment Plan ("HFAIP") will guide hedge fund investment activities of the Los Angeles County Employees Retirement Association (the "Fund" or "Total Fund") during the ~~2018~~2019 calendar year. It outlines the near term efforts towards meeting the long term objectives identified within LACERA's Hedge Funds Objectives, Policies, and Procedures ("OPP").

The Fund is currently invested in diversified fund of funds~~ and~~, credit fund of funds~~.~~, and direct hedge funds. As of June 30, ~~2017~~2018, approximately 2.~~7~~2% of the assets of the Total Fund are allocated to ~~hedge~~ Diversified Hedge Fund Investments. These are comprised of diversified fund of funds and direct hedge funds, which ~~is~~are below the ~~3.~~4% ~~target allocation.~~ new policy allocation to Diversified Hedge Funds in the asset category Risk Mitigating and Inflation Hedges adopted by the Board in 2018. The interim target allocation to ~~the~~Diversified Hedge Funds ~~Investment Program~~Investments is proposed to be 3% as of 2Q19 and increases ~~in a stepped manner~~ to ~~5~~4% at the end of ~~2018. This HFAIP and the OPP will guide LACERA's investment in a direct hedge fund portfolio to reach the 5% target over~~2019. Separately, LACERA has 0.7% of the Total Fund invested in Credit Hedge Fund of Funds which are now part of the ~~next calendar year. Much of this document addresses this plan to reach the 5%~~Credit allocation ~~target~~and no longer part of this Investment Plan.

This HFAIP and the OPP will guide LACERA's investment in a direct hedge fund portfolio to reach the 4% target for Diversified Hedge Funds over the next calendar year. Much of this document addresses this plan to reach the 4% allocation target. This document sets forth a capital plan for LACERA's Diversified Hedge Funds ~~Investment Program~~Investments (the "Program," "Hedge Funds," or "Hedge Funds Program"). Additional details on the Program are broadly outlined in LACERA's Investment Policy Statement ("IPS") and further detailed in the OPP, which provides the blueprint that guides the structure and administration of the Program and its underlying portfolios. The OPP also delineates the responsibilities of the Board of Investments (the "Board"), LACERA staff~~ ("Staff"),~~, the Hedge Funds Advisor(s) ("HFA"), the hedge funds portfolio administrator(s~~),~~) ("Administrator"), LACERA's custodian~~,~~ ("Custodian"), and LACERA's general consultant~~.~~ ("General Consultant").

SECTION I – PROGRAM OBJECTIVES

1. Introduction

The Board has determined that, over the long term, inclusion of diversified hedge fund investments will enhance the risk/return characteristics of the Total Fund. ~~The~~As established in the Investment Policy Statement ("IPS"), the Hedge Funds~~ Investment~~ Program has an objective to reduce the volatility of the Fund without materially decreasing Fund returns. Primarily, the Hedge Funds Program enhances the diversification of the Total Fund portfolio. This objective is achieved through investing in targeted strategies that have low to moderate correlation with public global equity returns, and have historically exhibited moderate return volatility. Hedge funds have historically had greater volatility than fixed income markets while having less than half the volatility of public global equity markets.

2. Role of Hedge Funds in the Total Fund

The IPS states that the Program objective–to reduce Fund volatility without materially decreasing Fund returns–should be measured and evaluated by the Sharpe ratio[1]. The Program is expected to improve the Sharpe ratio of the Total Fund. ~~-~~Even modest improvements in the Sharpe ratio benefit the Fund's ability to compound returns over the long run.

Investment decisions regarding the Program's primary objective of reducing volatility while maintaining returns are guided by the following separate objectives: (i) generating returns that exceed a target annualized return of ~~500~~250 basis points[2] greater than an index of 3-month United States Treasury bills ("T-bills"), (ii) achieving realized volatility of ~~5~~3-8% as measured by the annualized standard deviation of monthly returns, and (iii) maintaining a Program beta[3] of 0.25 or lower to public global equity markets as measured by the Morgan Stanley Capital International ("MSCI") All Country World Index.

3. Hedge Funds Asset Allocation

~~The~~

In May 2018, the Board established a long-term target allocation to ~~the~~diversified Hedge Funds ~~Program~~of 4%. This allocation is part of a newly-created Risk Reduction and Mitigation asset category that also includes investment grade fixed income and cash. Previously the asset allocation target for all hedge funds, including credit hedge funds of funds was 5% of the Total Fund asset value. ~~This 5% target allocation was established by the Board in October 2015. Since Program inception in 2011, the Board has approved several~~

Additionally, the new May 2018 policy re-categorized credit hedge fund of funds strategies, previously categorized under the Hedge Funds Program, to a new sub-category called Illiquid Credit within a new asset category named Credit. The credit hedge fund of funds portfolios ~~that are~~ comprised 0.7% of the Total Fund as of June 30, 2018. The new policy allocation to Illiquid Credit is 3%. The allocation to Illiquid Credit includes other investments apart from Credit hedge fund of funds and will be managed by ~~external fund of funds managers.~~ the Credit team and will continue to be

[1] Sharpe ratio is a measure of the excess return of the program over cash divided by program volatility as measured by standard deviation of returns.
[2] Subject to Board Approval. Benchmark review scheduled for September 12, 2018 BOI Meeting.
[3] Portfolio equity beta is a measurement of a portfolio's volatility relative to equity market returns. A portfolio with a beta of 1.0 has the same volatility as the equity market. Mathematically, historical beta can be viewed as the slope of the regression line of portfolio returns against market returns. The Morgan Stanley Capital International All Country World Index is used as the global equity market reference against which to measure equity beta realized by the Program.

overseen by the Credit and Risk Mitigation Committee (formerly Fixed Income/Hedge Funds Commodities Committee).

This Plan excludes any future investments in Illiquid Credit Hedge Funds as they will be overseen via a separate allocation process managed by the Credit team which looks at Credit Hedge Funds relative to all illiquid credit opportunities. Any reference to the Diversified Hedge Funds Investments (the "Program," "Hedge Funds," or "Hedge Funds Program") herein will exclude credit hedge fund of funds investments. As of June 30, ~~2017~~2018, the actual Hedge Funds Program allocation is 2.~~7% of the Total Fund[4]. Additionally, there remained $6 million of unfunded[5] commitments to Hedge Funds that are expected to be funded in 3Q 2017. This unfunded commitment represents 0.012~~% of the Total Fund~~ asset value.~~

[6]. As the actual allocation is currently below the long-term target allocation, which is planned to be reached in Q4 ~~2018,~~2019, an interim target ~~allocations~~allocation for Diversified Hedge Fund Investments is being recommended at the September BOI meeting to be 3.0% at the beginning of 2Q19. The Diversified Hedge Funds ~~have been developed and approved by the Board as part of the implementation plan for the 2015 Total Fund asset allocation~~ policy~~. This implementation plan has the Hedge Funds~~ allocation ~~increasing incrementally at the end of each year~~is planned to change in the following quarters as shown in **Table 1** ~~on the next page.~~below.

~~TABLE~~Table 1
Target Hedge Funds Allocation by Quarter

Calendar Quarter	Target Diversified Hedge Funds Allocation
Current	~~3.4~~2.2%
~~Q4 2017~~Q2 2019	~~4.2~~3.0%
Q4 ~~2018~~2019	~~5~~4.0%

The Total Fund asset allocation policy in the IPS limits the actual Hedge Funds allocation to a range around the target allocation whereby the minimum allocation is the lower of ~~3~~0% or 4% less than target, and the maximum allocation is 2% greater than the target~~ allocation. ~~. Thus, at the ~~current~~proposed 3~~.4~~% target allocation, the hedge funds allocation range is 0~~.4~~% to 5~~.4%. ~~%. At the final ~~5.0~~4% target allocation, the allocation range will be ~~2.~~0% to ~~7.0%.~~6%.

[4]~~Based on a $1.4 billion asset value of the Program and $52.5 billion Total Fund asset value.~~
[5]~~Capital committed by LACERA but not yet invested by the HFoF manager.~~
[6]$1.23 billion asset value of Hedge Funds and $56.0 billion Total Fund asset value.

4. Program Benchmark Return

~~To evaluate the performance of the Program,~~

A recommendation to the Board of Investments is being made at the September 2018 meeting which, consistent with the General Consultant's capital market assumptions, would make the primary Diversified Hedge Fund Program benchmark ~~is the~~an annualized return of 250 basis points greater than an index of 3-month United States Treasury ~~Bills plus 5% per annum,~~bills ("T-bills")[7]. The benchmark is used to evaluate the performance of the Program over three to seven years.~~-~~ When measuring realized returns against this objective, the returns are net of all fees charged by underlying hedge funds and any fund of funds managers.

Program returns are also measured against a universe of similar hedge fund strategies, as provided by a reliable third party source such as Hedge Fund Research, Inc. ("HFR"). ~~-~~By measuring performance over three to seven years, the Program's performance relative to a fund ~~-~~universe can be considered. ~~-~~**Table 2** identifies benchmarks for each portfolio type within the Program. ~~-~~A description for each portfolio ~~type~~ follows in Section 5 of this HFAIP.

~~TABLE~~Table 2
Fund Benchmarks by Type

Portfolio Type	Primary Benchmark	Secondary Benchmark
Diversified Hedge Fund of Funds	3 month T-bills plus ~~500~~250 bps annualized[8]	HFRX Global Index[9]
~~Credit Hedge Fund of Funds~~		~~HFRX Fixed Income–Credit Index[10]~~
Direct Hedge Funds~~[11]~~		~~HFRX Global Index~~
Total Diversified Hedge Funds Portfolio		~~HFRX Global Index~~

5. Investment Structure

The Fund currently invests in two diversified portfolio types in the Program (~~diversified~~ hedge fund of funds and ~~credit hedge fund of funds), and will be adding a third portfolio type (~~direct hedge funds).

[7] This benchmark has been 500 basis points greater than an index of 3-month United States Treasury bills ("T-bills") since the inception of the program.

[8] Subject to BOI approval.

[9]The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. ~~-~~It is comprised of all eligible hedge fund strategies, including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. ~~--~~The strategies are asset weighted. *Source: Hedge Fund Research, Inc.*

~~[10]The HFRX Fixed Income–Credit Index includes strategies with exposure to credit across a broad continuum of credit sub-strategies, including corporate, sovereign, distressed, convertible, asset backed, capital structure arbitrage, multi-strategy and other relative value and event driven sub-strategies. *Source: Hedge Fund Research, Inc.*~~

~~[11]Direct hedge funds portfolio is yet to be invested. See Section III.1 Capital Planning.~~

The Fund currently deploys capital to two Hedge Fund of Fund ("HFoF") managers ~~to invest in the two existing portfolio types. The first manager,~~ Grosvenor Capital Management ("~~Grosvenor"), runs~~ GCM") and Goldman Sachs Asset Management ("GSAM"). GCM and GSAM each run a diversified HFoF portfolio ~~and~~ for the Program.

GCM also runs two credit HFoF portfolios~~. The second manager, Goldman Sachs Asset Management ("GSAM"), runs a diversified HFoF portfolio.~~ which, as previously mentioned, are categorized under the Illiquid Credit sub-category in the Credit asset category.

As the Program implementation moves forward, direct hedge fund investments ~~will be~~are used for the advantages they provide to the Fund, namely that they are not subject to the additional layer of fees paid to fund of funds managers, they facilitate direct relationships with hedge fund managers, and they allow the Fund to have greater control over its Program.

In addition to their existing fiduciary role in investing the fund of funds portfolios, the HFoF managers have also agreed contractually to serve as HFAs, acting as a fiduciary, to support LACERA investing directly in hedge funds. ~~The HFAs will provide these services as a fiduciary.~~ The roles and responsibilities of the HFA are further described in the OPP. LACERA issued a Request for Proposal for a Consultant(s) in the Hedge Funds, Credit and Real Assets categories. When and if LACERA selects a separate Hedge Fund Consultant, the Consultant will act as an HFA.

Hedge Fund Program Portfolio Types

1. Diversified Hedge Fund of Funds: HFoF portfolio managed by an external HFoF manager who invests across ~~major~~ hedge fund strategies. HFoF managers have discretion to construct portfolios consistent with the Hedge Fund section of LACERA's Investment Policy Statement and any individual portfolio guidelines. Each HFoF manager identifies, selects, and monitors these investment strategies as part of a diversified portfolio.[12]
~~2. Credit Hedge Fund of Funds: HFoF portfolio managed by an external HFoF manager that invests primarily in credit strategies. These strategies typically are oriented to longer-term investments and require capital lock-up periods of one to five years, generally longer than those in the Diversified HFoF. These investments are held in limited-life vehicles whereby substantially all of the capital is expected to be returned within the limited life of the vehicle.~~

~~3.~~2. Direct Hedge Funds: ~~Portfolio~~ Diversified portfolio of hedge funds invested across ~~major~~ hedge fund strategies, with LACERA selecting the ~~hedge funds.~~

[12]The Fund's contractual relationship with Goldman Sachs Asset Management regarding the diversified HFoF portfolio is through a discretionary investment management agreement rather than a fund agreement in part because those underlying funds are held directly in the Fund's name.

managers and strategies. LACERA retains discretion to construct and maintain a portfolio consistent with the Program policies including the OPP and this HFAIP. As additional resources, the HFAs provide independent due diligence and technical assistance to LACERA in support of areas including market research, ~~manager~~investment due diligence, operational due diligence, portfolio construction, and risk aggregation.

SECTION II – FUTURE INVESTMENT ACTIVITY

~~6.~~1. Hedge Funds Investment Pacing

The Program value and allocation as a percentage of the Total Fund are expected to increase over the coming quarters due to ~~changes in two portfolios. The first Credit HFoF portfolio is expected to return nearly all~~continued build out of ~~its remaining $193 million (as of June 30, 2017) in capital in 2017 and in early 2018 as its five-year scheduled life comes to an end.~~the direct portfolio. LACERA ~~will begin~~began investing capital in a direct portfolio in ~~2017.~~ 2018.

While these changes will result in an increase in the expected allocation to 3.0% of the Total Fund at ~~year end 2017~~the beginning of Q2 2019, this is below the 4.~~2~~0% target hedge fund allocation at year end ~~2017~~2019 shown in **Table 1**.

LACERA has a target to reach a ~~5~~4.0% diversified hedge fund allocation by ~~year-end 2018.~~ the beginning of Q4 2019. **Table 3** summarizes expected quarterly investment pacing of the Program over the ~~2018~~2019 calendar year.

~~**TABLE**~~

While this section describes a pacing model for the continued implementation of the direct hedge fund portfolio, other considerations for the Hedge Fund program priorities may also affect or delay the timing of this plan. These include the selection and implementation of a new Hedge Fund Consultant, implementation of a separately managed account platform for hedge fund strategies, market conditions, and the implementation of an emerging manager program.

Table 3
~~EXPECTED INVESTMENT PACING~~

Investment Pacing – Direct Hedge Funds Portfolio

			~~Change in Investments ($ millions)~~			
Calendar Time Period	**~~Investment in Second Credit HFoF~~**	**~~Redemption from First Credit HFoF~~**	**Estimated Investment in Direct Hedge Funds Portfolio**	**Reduction in Diversified HFoF Portfolio**	**~~Expected~~Estimated Ending Value of Diversified Hedge Funds ($ millions)**	**% of Total Fund[13]**
3Q18~~3Q17~~			~~6~~$25	~~($78)~~	$1,~~371~~255	2.~~6~~2%
~~4Q17~~4Q18		~~($71)~~	$250		$1,~~550~~505	~~3.0~~2.7%
~~1Q18~~1Q19		~~($24)~~	$250		$1,~~776~~755	3.~~4~~1%
~~2Q18~~2Q19			$250		$2,~~026~~005	3.~~9~~6%
3Q19			$235		$2,240	4.0%
4Q19~~3Q18~~			$250	($250)	$2,~~276~~240	4.~~3~~0%
~~4Q18~~				~~($20)~~	~~$371~~	~~$2,627~~ ~~5.0%~~
Aggregate ~~2018~~2019			$985	($~~44~~250)	~~$1,121~~	

2. Future Investment Structure by Portfolio Type

Table 4 ~~on the next page~~ shows the current allocation to the portfolio types within LACERA's Hedge Funds Program and defines the allowable allocation range for the Program. ~~-~~With the planned pacing described in **Table 3**, the expected allocation to the ~~three~~two portfolio types at the end of calendar year ~~2017,~~ 2018 ~~and~~, 2019 and 2020 is also shown in **Table 4**~~.~~

The allocation to a direct portfolio is expected to move from ~~0%~~21% as of June 30, 2018 to ~~52~~68% of the Program by the end of calendar year ~~2018.~~ 2019. Diversified HFoFs are expected to decline from ~~64~~79% of the Program to ~~35% and credit HFoFs are expected to decline from 36% to 13% of the Program.~~ 32%. Allocations by portfolio type are expected to stay in the allowable allocation ranges during the next two years.

[13] Estimate based on June 30, ~~2017~~2018 Total Fund asset value, excluding any investment return from Hedge Funds and Total Fund subsequent to June 30, ~~2017~~2018.

Table 4
~~**LACERA HEDGE FUND CURRENT AND ALLOWABLE ALLOCATION BY PORTFOLIO TYPE**~~

LACERA Hedge Fund Current And Allowable Allocations By Portfolio Type

Portfolio Type	Asset Value as of ~~June~~Jun 30, ~~2017~~ 2018 ($ millions)	Allocation % as of ~~June~~Jun 30, ~~2017~~2018	~~Expected Dec. 31, 2017 Allocation %~~	~~Expected~~ Estimated Dec~~.~~ 31, 2018 Allocation %	~~Expected~~ Estimated Dec~~.~~ 31, 2019 Allocation %	Allowable Allocation Range
Diversified Hedge Fund of Funds	~~91~~974	~~64~~79%		~~60~~65%	~~35~~32% ~~19%~~	~~15~~0-90%
~~Credit Hedge Fund of Funds~~	~~524~~	~~36%~~		~~24%~~	~~13%~~ ~~13%~~	~~10-45%~~
Direct Hedge Funds	~~0.0~~255	~~0~~21%		~~16~~35% ~~52%~~	68%	0-~~75~~100%
Total Program	**$1,~~443~~229**	**100%**		**100%**	**100%**	~~**100%**~~

~~3. Note: If $6 million in unfunded commitments to the credit HFoF was funded and added to the existing Program, the credit HFoF would be 37% of the total Hedge Funds Program and the diversified HFoF would be 63% of the Program, as of June 30, 2017.~~

~~7.~~3. Investment Strategy Categories

LACERA's achievement of its Hedge Funds Program objectives requires an ability to adjust portfolio allocations across various hedge fund strategy categories since each may respond differently to prevailing market environments. The Program-level investment category constraints (shown in **Table 5)** limit strategy category exposures in order to promote diversification across strategy categories while also being flexible enough to allow for tactical shifts in and out of strategies based on their relative attractiveness and the market environment.

The constraints for each of the six investment strategy categories (defined and discussed below) are measured on a look-through basis.[14] ~~Additionally, individual~~Individual fund of fund portfolios have investment guidelines that are consistent with or more limiting than these Program-level constraints.

Definitions for the categories generally draw from the index definitions created by HFR. HFR's definitions of the first four categories in the table are objective and follow predetermined rules which place all eligible hedge funds in their Global Index into one of these four categories. However, solely using these four definitions ~~are~~can be limiting to broad portfolio construction, and LACERA has broadened the strategy categories to include Hedged Credit and Multi-Strategy. While the six categories are commonly used, they do not represent an exhaustive list that covers all possible hedge fund investments. The Program may invest in some funds that are not well ~~categorized~~ described by one of these ~~strategies~~strategy definitions if they otherwise meet ~~the other~~broad objectives and constraints established for the Program~~.~~

Additionally, LACERA may consider investing in "hedge fund premia" or replication-type strategies that seek to obtain systematic exposures to investment themes used by hedge funds~~ or market exposures~~, but at a lower cost. These strategies are expected to fall within the six strategy categories ~~shown~~identified below.

Table 5
~~TOTAL PROGRAM~~ Diversified Hedge Funds
Investment Allocation Constraints
by Strategy Category

	Strategy Constraint	Current Look-Through Allocation	Target Allocation of Direct Portfolio	Estimated Overall Allocation at year end ~~2018~~2019
Event Driven (excluding Credit)	Maximum 40%	~~7~~12%	7.5%	~~8~~11%
Relative Value	Maximum 60%	~~13~~12%	15%	15%
Hedged Equity ~~Hedge~~	Maximum 40%	~~16~~20%	15%	~~17~~20%
Macro ~~(Directional~~/Tactical~~)~~ Trading	Maximum 50%	~~18~~16%	15%	18%
Hedged Credit	Maximum 60%	~~42~~11%	7.5%	~~20~~10%
Multi-Strategy	Maximum 60%	429%	40%	~~23~~26%

[14] Look-through basis for the Hedge Funds Program is defined as the total strategy category allocation based on the underlying portfolios in the Program, viewed independently of their portfolio structure.

The table includes the target allocation for the direct portfolio when it is fully invested by year end ~~2018. Over the coming year the addition of the direct portfolio, and the ending of the first credit HFoF is expected to increase the percentage allocation to multi-strategy managers while reducing the allocation to credit managers.~~ 2019. The estimated strategy allocation at calendar year end ~~2018~~2019 is shown in the final column, with the assumption that the direct portfolio is invested at its target allocation at the end of ~~2018~~2019.

LACERA recognizes the opportunistic nature of investing in these strategies and will allow ~~Staff and the HFoF managers~~ latitude regarding the lower and upper limits of allocation constraints and targets. In the short term, as LACERA ~~builds~~sequentially ramps up its allocations in the direct portfolio to reach the ~~5~~4% Total Fund target allocation, some individual fund allocations may cause large changes in the strategy allocation weights in the direct portfolio. Thus, these strategy constraints might not be met during the ramp up phase.

4. Portfolio Guidelines and Risk Parameters

The Hedge Fund Program and direct portfolio guidelines and risk parameters set forth in the OPP, such as liquidity, will be maintained when the direct portfolio is constructed. Program-level compliance for the portfolio guidelines and risk parameters will be reported quarterly to the Board of Investments in a section of the quarterly performance book.

5. Geographic Allocation

LACERA does not currently categorize managers by geographic concentration, as there is not a stated objective to allocate capital by region. Managers are given flexibility to invest where they find opportunity based on where they have demonstrated ability to add value, regardless of whether the region includes the United States or not. A relatively small number of managers invest solely in markets outside the U.S. Some invest on a global basis and many invest solely or mostly in U.S. markets. Staff will monitor regional and country exposures on a look-through basis so that significant unintentional regional or country exposures ~~do not arise.~~ can be managed.

6. Manager Concentration

Allocation limits to individual investment management organizations or funds are set by guidelines for the hedge fund of funds managers. For the Direct Hedge Funds portfolio, investment in an individual fund is limited to 20% of the market value of the direct portfolio.

~~On a look-through basis, the Program currently does not have large exposures to any individual investment management organizations. LACERA currently has greater than 5% exposure to an investment management organization through its fund of funds. 6.0% of the Program is invested with Chenavari Credit Partners, LLP. The manager has two separate funds in which LACERA is invested. This organization is expected~~

~~to be below 5% of the Program value at the end of 2018, unless LACERA selects this firm to manage an investment in LACERA's direct hedge fund portfolio.~~

SECTION III – ~~2017~~2018 INVESTMENT ACTIVITY

1. Calendar year ~~2017~~2018 Investment Activity
~~In 2016,~~

LACERA ~~began investing~~ has invested $285 million in ~~its second credit~~three separate direct hedge ~~fund of~~ funds ~~vehicle, named San Gabriel 3. LACERA committed $300 million to this five-year fund vehicle~~through August 2018.This portfolio is described in ~~late 2015. As of June 2017, $294 million of~~ the ~~commitment has been funded~~regular quarterly Hedge Fund reporting and ~~$6 million remains unfunded.~~

~~Also~~new fund cash flows are included in ~~2016, San Gabriel 2, a credit hedge fund of funds vehicle with a vintage year in 2013, began returning capital. Through June 2017, San Gabriel 2 had returned $66.6 million~~the monthly CIO letter.

SECTION IV – NEAR TERM AND FUTURE PRIORITIES

1. Near Term and Future Priorities

This HFAIP and the OPP recommend a pace of investing that will result in ~~an allocation to reach~~reaching the ~~5~~4% target allocation by ~~end~~beginning of ~~calendar 2018.~~ Q4 2019. Much of the capital pacing in this HFAIP reflects ~~new~~ allocations to newly approved managers to ~~construct~~build up the direct hedge fund portfolio.

After the full ~~5~~4% strategic target allocation to Hedge Funds is reached (expected by Q4 ~~2018~~2019), allocations will be moved from diversified hedge fund of funds to direct hedge funds, so that each diversified hedge fund of funds portfolio will be reduced to an approximate net asset value of $250 million. $250 million was the initial amount allocated to each HFoF manager at their inception. Such an allocation is expected to maintain the level of services required to support their role as a Hedge Fund Advisor. Beyond ~~2018~~2019, approximately ~~20~~22% of the Program would be in diversified HFoFs after LACERA reaches its ~~5~~4% strategic allocation target and after the diversified HFoFs are brought down to $250 million each.[15]

Once each diversified HFoF portfolio is brought down to approximately $250 million, LACERA may re-evaluate the role of its HFoF managers ~~and HFAs in its Program.~~ . At that time, LACERA may consider alternative structures for the Program that eliminate one or both HFoF managers ~~and consider~~. LACERA is currently soliciting for the retention of ~~an~~a HFA that acts in a purely advisory capacity ~~—~~ which provides flexibility to eliminate one or both diversified funds of funds structures entirely if desired.
~~Once~~

[15] Based on current total fund asset value of $~~52.5~~56 billion.

LACERA may also consider alternatives to the ~~full 5% allocation is reached~~current mandates for the fund of funds managers. For example, LACERA may wish to consider changing the mandates to be more targeted to a specific strategy, manager profile, or geographic region where a fund of funds manager may be better resourced than LACERA to accomplish.

In 2019, LACERA will also ~~consider its options~~explore strategies through Committee and Board discussions for constructing an emerging manager hedge fund portfolio. Such strategies may include converting all or a portion of an existing Diversified HFoF portfolio mandate to an Emerging Manager HFoF portfolio mandate or working with a new non-discretionary HFA to build a direct Hedge Fund Emerging Manager Program. This portfolio would follow ~~the~~new policies and objectives for emerging manager portfolios that already exist in LACERA's other asset ~~classes~~categories.

SECTION V – MARKET OUTLOOK

1. Market Outlook

The following pages describe the current outlook for hedge fund strategies from LACERA's hedge fund advisors, GSAM and ~~Grosvenor.~~ GCM. Neither HFA currently expresses a significant view towards or against any individual hedge fund strategy category. LACERA will generally invest in a balanced manner across the various strategies ~~with an emphasis on~~including multi-strategy managers who have the ability to invest tactically across strategies.

GSAM's current ~~view~~market outlook includes mainly neutral views across hedge funds with positive views for select sub strategies in ~~balanced hedged equities, volatility trading in~~ tactical trading, including trading ~~and select credit strategies in leveraged loans~~monetary policy, emerging ~~market credit~~markets and ~~private credit.~~ volatility. Their view is ~~most positive in multi-style macro strategies. Their view on directional equities, most~~neutral overall for event- driven strategies, ~~and developed markets sovereign debt and currencies in tactical trading are modestly less attractive.~~most segments of the credit markets, and equity long/short.

Grosvenor's market outlook and investment focus includes strategic allocations across all major strategy categories with volatility trading the most favorable. ~~Tactical allocations are currently made to opportunistic credit, specialized hedged equity in the financial, energy, healthcare, and biotechnology sectors, special situations in litigation finance, the energy sector, a bridge loan in an emerging market utility and commercial real estate mezzanine loan portfolios, and relative value volatility arbitrage strategies.~~Their views are mixed/neutral for equities and commodities/currency trading. Their views are mixed/unfavorable for credit and rates trading.

AIMS Hedge Funds and Public Equity

Strategy Views

Goldman Sachs Asset Management

AIMS One Year Forward Looking View [1]

	Less Attractive						More Attractive	Change From Prior Quarter
Equity Long / Short				●				↓
Directional			●					
Moderate				●				
Balanced					●			↓
Event Driven			●					↓
Soft Catalyst / Higher Beta			●					
Merger Arbitrage				●				
Hard Catalyst / Lower Beta			●					↓
Activism			●					
Tactical Trading				●				
Macro - G3 Multi-Asset			●					↓
Macro - G3 Fixed Income / FX			●					↓
Macro - Multi-Style						●		↑
Quant - Multi-Style				●				
Quant - Trend-bias				●				
Quant - Trend Following				●				
Commodities				●				
Volatility Trading					●			
Credit				●				
Municipal Debt				●				
Liquid Corporate – Investment Grade				●				
Liquid Corporate – High Yield				●				
Liquid Corporate – Leveraged Loans					●			
Structured / ABS				●				
Growth and Emerging Markets					●			
Spec Sits/ Distressed/ Opportunistic				●				
Private Lending					●			

Key Points

- **Equities:** We have a constructive view for equity long/short strategies, driven by a neutral outlook on the opportunity set for both alpha generation and equity beta. This leads us to prefer managers with more balanced net exposure over directional or moderate managers. Upgrade our view on long-only to neutral due to a more attractive view on international equities due to improved earnings growth and relatively cheap valuations.
- **Event Driven:** Maintain a cautious view for event driven strategies driven by reduced equity return expectations over the next 12-months on higher beta segments of the universe (soft catalyst and activist), coupled with lower expected returns for credit/distressed managers given historically tight spreads. We remain neutral on merge arbitrage given spreads remain near the historical average despite a meaningful tightening year-over-year.
- **Tactical Trading:** Maintain our constructive view for tactical trading strategies, expressed as an overweight to Multi-style and relative value volatility trading. This quarter we moved from neutral to negative for G3 Macro while we wait for concrete signs of a better opportunity set in the absence of consistent trends, low market volatility, and central bank intervention. An overweight to Multi-style macro has been driven by a constructive view on EM and more niche, idiosyncratic opportunities.
- **Credit:** Maintain our constructive view for credit strategies overall. Broad-based, public large-cap distressed corporate opportunities remain fleeting, given the sharp reversal in the leveraged credit markets; however, the large volume of CCC-rated debt issued post crisis, and the wave of pending CMBS refinancing likely portends opportunities ahead. Alternatively, private-market distressed strategies continue to show that pockets of potential, idiosyncratic opportunities remain in special situations investments. Further, as rates continue to rise, floating rate leveraged loans are enjoying technical tailwinds that will likely drive prices higher going forward.

[1] Source: AIMS. As of June 2017. Colors represent views by sector. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice.

Strategic and Tactical Investment Focus (August 2017)

Hedge Fund Strategies

Strategic allocation		Tactical allocation	
Credit	▪ Corporate and structured credit, including both long-biased and long/short approaches ▪ Investments that seek to exploit asset class dislocations and arbitrage pricing anomalies ▪ Stressed and distressed underlying securities ▪ Complex, idiosyncratic and event-driven investments	Opportunistic credit	▪ Opportunities related to the deleveraging of the European financial sector ▪ Emerging market stressed and distressed credit ▪ Energy sector-related opportunities in negotiated and distressed public credit ▪ Other structured credit and specialty finance strategies
Equity	▪ Globally-focused, hedged equity investments across regions and sectors ▪ Seek low correlation among funds through a mix of generalists and specialists that employ various styles and exposure biases ▪ Fundamental research-oriented approach ▪ Quantitative equity market neutral strategies	Specialized hedged equity	▪ Financial sector ▪ Energy sector ▪ Healthcare and biotechnology sectors
Relative value & multi-strategy	▪ Flexible mandates across strategies ▪ Niche strategy exposures (e.g., converts, capital structure arbitrage) ▪ Lower beta and correlation; less market dependence	Special situations	▪ Portfolio of litigation finance cases involving international commercial arbitration disputes ▪ Direct investments in post-restructured equities of U.S. energy E&P companies ▪ Senior, secured, short-term bridge loan and preferred equity stake in emerging market utility ▪ Tactical purchase of a seasoned portfolio of commercial real estate mezzanine loans from a liquidating hedge fund
Macro & commodities	▪ Low correlation; seek downside loss mitigation ▪ Highly liquid and flexible; diversified by style, asset class and instrument ▪ Includes emerging market macro strategies	Relative value	▪ Fixed income, FX, and equity volatility arbitrage

Our strategic allocations are implemented through core allocations to alternative credit and hedged equity strategies, complemented with allocations to diversifying and lesser correlated strategies.

Our portfolio construction is enhanced through focused tactical investments designed to capture niche and/or timely market opportunities.

All investments discussed herein are subject to certain risks and a summary of these risks are set forth in the disclosures following this presentation.

GCM GROSVENOR

Market Factor Review and Outlook

3rd Quarter 2017

Factor / Outlook	Views
Economic factors Mixed	▪ Global real GDP growth is expected to be 2.7% and 2.9% in 2017 and 2018, respectively. U.S. real GDP growth estimates remain at 2.1% and 2.2% in 2017 and 2018[1] ▪ The U.S. Federal Reserve is expected to continue with tight monetary conditions after raising rates for the second time in 2017 ▪ With Macron's victory in the May French elections, investor attention in Europe now turns to the start of Brexit negotiations ▪ Ongoing concerns regarding RMB depreciation and slow growth in China and its impact on emerging markets and commodities ▪ Uncertainty surrounding healthcare reform and the implications on Trump's legislative agenda ▪ Heightened geopolitical and terrorism concerns ▪ Following two years of deep recessions, the World Bank still projects Brazil and Russia will see positive growth in 2017[1] ▪ The yen acted as a safe haven against turmoil on the Korean peninsula, holding onto most of its Q1 gains versus the USD
Credit Mixed/ Unfavorable	▪ Reflation theme present as CCC rated bonds in the HY index have generated greater total returns over last 18 months relative to AA rated bonds and above ▪ Corporate credit spreads in the U.S. and other developed markets remain at historically tight levels ▪ Concerns surrounding ECB tapering led to EUR bond underperformance ▪ Heightened interest rate sensitivity continues to persist in the HY market ▪ Global bond selloff deepened in Q2 as central banks hinted at ending accommodative money policies
Equities Mixed/ Neutral	▪ Global equities increased in Q2 2017 ▪ The Schiller P/E ratio continued to increase, closing Q2 at its highest level in the post-2008 era ▪ Emerging markets continued to rally in Q2; outlook is for wider-than-historical dispersion
Volatility Favorable	▪ FX and rates volatilities are expected to increase amid political and policy uncertainty ▪ Divergence in policies of global central banks may continue to increase volatility ▪ The VIX plunged below 10 in May and remains near historical lows
Rates Mixed /Neutral	▪ The ECB and the Bank of Japan have large-scale monetary easing policies in place ▪ The US Federal Reserve raised rates in June with a third hike widely expected for late 2017
Commodities/ currencies Mixed/ Unfavorable	▪ The U.S. Dollar depreciated against a basket of global currencies in Q2 2017, falling below pre-U.S. election levels ▪ Oil prices continued to decrease due to increased U.S. output ▪ We expect central bank policies to continue to influence currency trends

1 World Bank, Global Economic Prospects. June 2017.
Data sources: Bloomberg; Financial Times.
These views represent GCM Grosvenor's good-faith expectations concerning future opportunities and can not be viewed as indications of whether particular opportunities will occur. All investments discussed herein are subject to certain risks and a summary of these risks are set forth in the disclosures following this presentation.

GCM GROSVENOR

Public Equities and Equity Long / Short Outlook

Rising stock correlations and EPS growth remain in focus

Goldman Sachs Asset Management

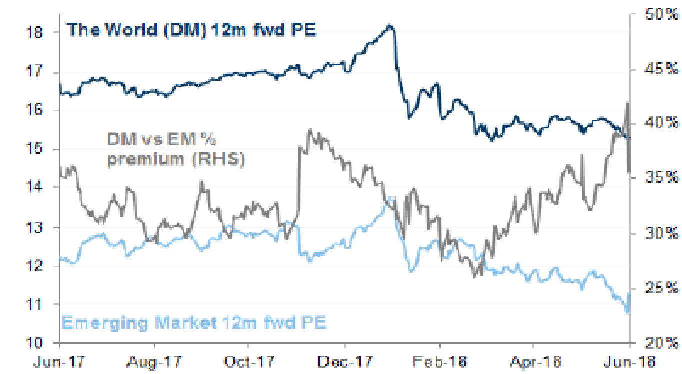
AIMS outlook

- Neutral outlook for equity long/short managers on both the alpha generation and equity beta opportunity; volatility and stock correlations have fallen back from high levels in Q1'18
- Prefer managers with more balanced net exposure and diversified, less-crowded alpha drivers, rather than directional managers in crowded hedge fund themes; when taking equity beta we favor high quality/secular growth biased exposure
- Neutral view on long-only equities driven by a more positive view on international equities due to improved earnings growth and relatively cheap valuations; more constructive on Emerging Markets equities

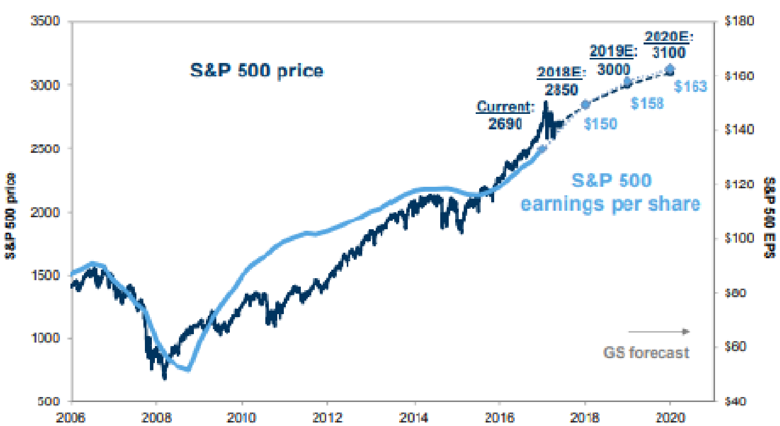
Top 5 potentially investable themes

1. **Rising rates potential tailwind for active management –** Improving opportunity set for shorting and a driver of higher stock price dispersion
2. **Positive signals outside of the US –** Cheaper valuations and constructive economic indicators provide a fruitful environment for stock picking
3. **Narrow valuation dispersion and modest economic growth in the US –** Could support further outperformance of growth
4. **Attractive entry point for MLPs –** Valuations and fundamentals remain supportive
5. **Potential long/short opportunities in therapeutics healthcare –** Supportive fundamental, regulatory, and capital market forces coupled with evolving research and technology

EM trading at higher than average discount to DM[1]



Earnings: S&P 500 earnings and index targets[1]



Source: AIMS Group, Morningstar Bloomberg, MSCI. As of June 2018. [1] Source: GIR. As of June 2018. For illustrative purposes only. Past correlations are not indicative of future correlations, which may vary. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice. Investors cannot invest directly in indices.

Event Driven & Credit Hedge Funds Outlook

Maintain neutral outlook for merger arb & multi-strategy

Goldman Sachs Asset Management

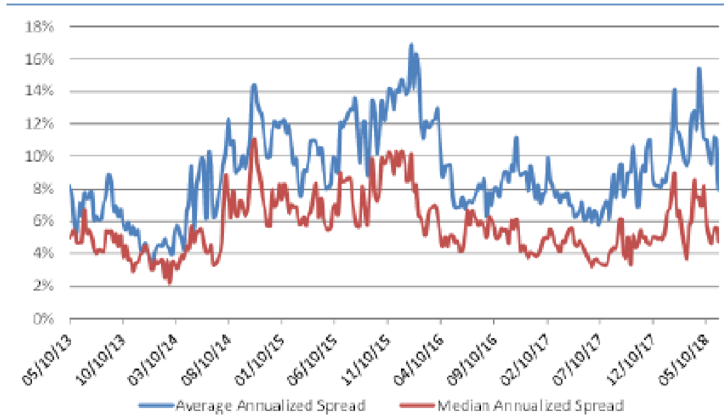
AIMS outlook

- Maintain overall neutral outlook for event driven strategies. Most notably, we have maintained our neutral outlook for merger arbitrage as spreads on vertical and media-related mergers have rallied, offsetting the perceived reduced regulatory risk
- We believe the current environment will favor managers with strong deal underwriting capabilities as we have observed a divergence in merger spreads between perceived safe deals and those with higher risk of regulatory intervention
- We maintain a neutral outlook for most segments of the credit market, focusing our investments on segments of the market offering correlation benefits (e.g., structured credit, insurance)

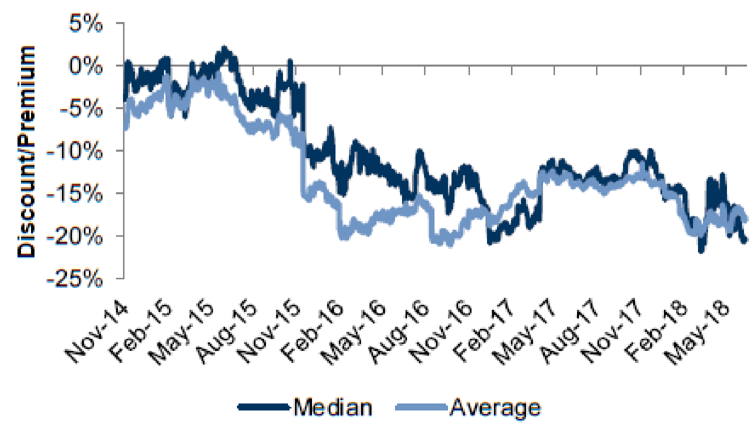
Top 5 potentially investable themes

1. **Event driven** – "Stub trades"[4] have the potential to offer idiosyncratic returns, with US tax reform serving as a catalyst for spread compression
2. **Distressed opportunities** – While the proportion of bonds and loans trading at stressed/distressed levels remains low, there are still select opportunities in retail, telecom and energy.
3. **Structured / ABS** – Asymmetric way to implement bearish retail view, specifically on Class B/C malls, via CMBX shorts
4. **Structured / RMBS** – The credit cycle for housing is much younger than for corporate credit, supporting the risk-adjusted opportunities in legacy non-agency RMBS and Agency CRTs
5. **Growth & emerging markets** – Relatively attractive carry and risk-adjusted return potential, particularly in select LatAm markets

Annualized merger arb spreads[1] remain modest but volatile[2]



Premium / Discount of HoldCos to Listed Subsidiaries[3]



Source: AIMS Group, Barclays, Bloomberg. As of June 2018. [1](0%- 50% annualized). [2] Source: Bloomberg, UBS Special Situations. As of June 15, 2018. [3] Source: Bloomberg. Includes 4-9 different commonly held stub trades. For illustrative purposes only. Past performance does not guarantee future results, which may vary. Past correlations are not indicative of future correlations, which may vary. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice. Investors cannot invest directly in indices. [4]Capturing the spread between the share price of listed holding companies and their listed subsidiaries.

Tactical Trading Outlook

Attractive opportunities to trade monetary policy, emerging markets and volatility

Goldman Sachs Asset Management

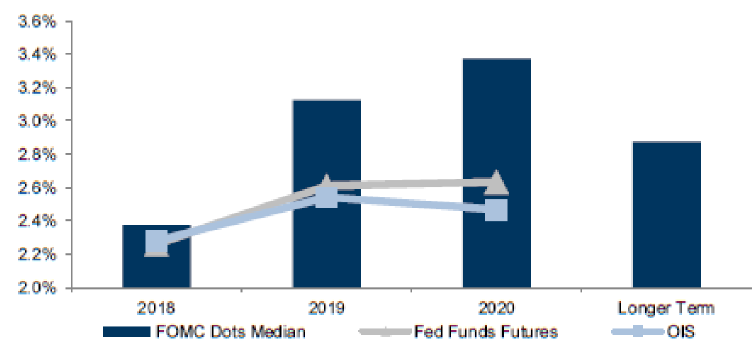
AIMS outlook

- Monetary policy normalization and higher volatility could present opportunities for tactical trading managers as rates rise and QE unwinds
- However, the gap between views and market pricing is now mostly further out on the curve, making potential exogenous shocks from trade and geopolitics more challenging to trade.
- Emerging markets offer long/short opportunities with managers still finding attractive niche areas. Valuations have improved but higher US rates, a stronger US dollar and upcoming elections could pose challenges.

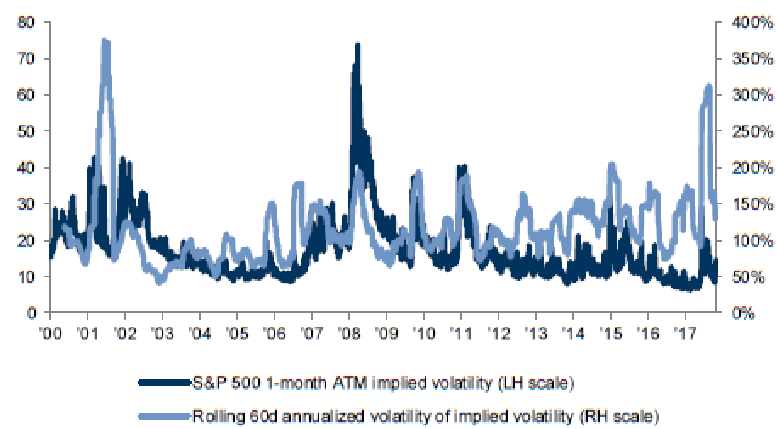
Top 5 potentially investable themes

1. **Fixed income** – changing supply and demand dynamics with relative progress of central bank tightening and transition may create opportunities for RV and directional trading
2. **EM** - managers are finding niche opportunities, as idiosyncratic events may be mispriced. Differing monetary policies and political cycles can create long/short opportunities.
3. **Volatility** – with implied and realized vol remaining close to historical lows, there may be opportunities for long-biased volatility trading and thoughtful tail risk managers
4. **US fiscal policy** – fiscal stimulus could have significant growth and monetary policy implications
5. **FX** – Central bank tightening may increase yield differentials and impact trade and flows, with opportunities in DM and EM

Markets are pricing fewer hikes than the Fed dot plot[1]



Volatility has picked up after hitting all-time lows in 2017[2]



Sources: AIMS Group, Morningstar Bloomberg, MSCI. As of June 2018 . [1]Source: Bloomberg. As of June 2018. [2]Sources: GSAM, Bloomberg. As of June 2018 For illustrative purposes only. Past correlations are not indicative of future correlations, which may vary. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice. Investors cannot invest directly in indices.

Market Factor Review and Outlook

3rd Quarter 2018 (1 of 2)

Factor / Outlook	Views
Economic factors Mixed/Unfavorable	▪ While the global economic expansion is expected to continue through 2019, with global real GDP estimated to increase by 3.90% in both 2018 and 2019, there are mounting risks to the economic outlook. Economic growth has not only peaked across a number of major economies, but growth has also become more uneven among both developed and emerging market economies.[1] ▪ The US Federal Reserve is expected to continue tightening monetary conditions after raising interest rates in June for the third time in as many quarters. The Fed's June dot plot indicated an expectation of two additional rate hikes in 2018, increasing its total number of projected interest rate hikes to four in 2018. ▪ The Trump administration's threat to impose tariffs on $500 billion worth of Chinese imports raised fears of a prolonged trade war between the world's two largest economies. ▪ Increased trade tensions risk undermining the global economy and devolving into a full-fledged currency war. ▪ November's midterm Congressional elections and their potential impact on the US political landscape and Trump's legislative agenda. ▪ With less than one year remaining until Brexit takes effect in March 2019, UK and EU officials continue to negotiate the terms of a withdrawal treaty. The prospect of a "soft Brexit" led to a number of high profile resignations from Theresa May's cabinet, including Foreign Secretary Boris Johnson and chief Brexit negotiator David Davis. ▪ The Five Star Movement and League political parties in Italy are viewed as anti-Euro, and despite somewhat softened rhetoric regarding a potential Italian exit from the EU, risks in the region are elevated. ▪ Concerns regarding elevated equity valuations and potential disruptions from ongoing reforms temper an otherwise positive outlook for India. ▪ Easing tensions on the Korean peninsula and the Bank of Japan's commitment to its negative interest rate policy contributed to yen weakness.
Credit Mixed/Unfavorable	▪ While credit spreads have widened somewhat from Q1's historically tight levels, spreads remain reasonably tight and there have not yet been dislocations that create significant directional credit opportunities. ▪ Treasury yields closed Q2 at their highest levels since 2011 as the unemployment rate reached its lowest level since 1999. ▪ Spreads in the BBB market remain historically tight relative to US Treasuries. ▪ Heightened interest rate sensitivity continues to persist in the HY market. ▪ EM credit faces acute challenges driven by both global macroeconomic issues (trade and rates) and idiosyncratic missteps in individual markets (most notably in Argentina, Venezuela, and Turkey). ▪ The global bond selloff continued in Q2 as central banks hinted at ending easy-money policies in the face of a stronger global recovery.

1 International Monetary Fund, World Economic Outlook. April 2018.

Data sources: Bloomberg; Financial Times. MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI; S&P. S&P and its third-party information providers do not accept liability for the information and the context from which it is drawn.

Unless apparent from context, all statements herein represent GCM Grosvenor's opinion. No assurance can be given that any investment will achieve its objective or avoid losses.

GCM GROSVENOR

Market Factor Review and Outlook

3rd Quarter 2018 (2 of 2)

Factor / Outlook	Views
Equities Mixed/ Neutral	▪ Global equities climbed higher in Q2 2018, with the S&P 500 and Russell 2000 rising 3.43% and 7.43%, respectively. ▪ The Shiller P/E ratio remains at its highest level since 2001. ▪ Emerging markets saw large losses in Q2 with the MSCI Emerging Markets Index down -7.86%. Outlook is for wider-than-historical dispersion.
Volatility Favorable (higher)	▪ After spiking in Q1 to its highest level since 2015, the VIX steadily declined to its historical average in Q2. For the year, volatility continues to recover from the historic lows observed in 2017. ▪ Divergences in global central bank policies may continue to increase volatility. ▪ Volatility is expected to continue in the coming months due to concerns over the economic factors listed above.
Rates Mixed /Unfavorable	▪ The ECB and the Bank of Japan currently have large-scale monetary easing policies in place. ▪ The ECB announced in June that it will end its monthly asset purchasing program after December 2018 and that it will hold interest rates unchanged through at least Q2 2019. ▪ The US Federal Reserve expects to raise interest rates four times in 2018.
Commodities/ currencies Mixed/ Neutral	▪ The US Dollar appreciated against a basket of global currencies in Q2 2018. ▪ We expect continued volatility as central bank policies continue to influence currency trends. ▪ Geopolitical tensions drove oil prices up over 11% in Q2 to a nearly four-year high of $72 per barrel.

Data sources: Bloomberg; Financial Times. MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI; S&P. S&P and its third-party information providers do not accept liability for the information and the context from which it is drawn.

Unless apparent from context, all statements herein represent GCM Grosvenor's opinion. No assurance can be given that any investment will achieve its objective or avoid losses.

GCM GROSVENOR

SUMMARY STATEMENT

This document outlines the near term capital plan for LACERA's Hedge Fund Program as its structure transitions from one invested ~~entirely~~primarily in discretionary diversified fund of funds to one which ~~also includes a directly invested~~primarily consists of direct hedge fund ~~portfolio.~~ investments. Subject to future modifications by the Board, this document establishes the investment pacing for the Program over the next calendar year as LACERA increases its investment in hedge funds to reach its ~~5~~4% strategic allocation target (which is expected by the beginning of Q4 ~~2018~~2019).

This Investment Plan will be updated annually to meet the evolving needs of the Hedge Fund Program. Updates concerning progress or meaningful challenges will be communicated or discussed with the ~~Fixed Income/Hedge Funds/Commodities~~Risk Reduction and Mitigation Asset Committee or Board, as appropriate~~. Once investments are funded within the direct portfolio, Staff will enhance the quarterly Hedge Fund Program Performance Report to address matters such as investment pacing, portfolio positioning, and direct portfolio performance~~.

APPENDIX

Descriptions of six main Hedge Fund Strategy Categories

Event Driven Strategies

Event Driven ("ED") strategies invest in securities of companies undergoing or expected to undergo corporate transactions, including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance, or other capital structure adjustments. Security types may include equities; senior, junior, or subordinated debt; and derivatives. ED investments may include exposure to equity markets, credit markets, and idiosyncratic, company-specific developments. Investment ideas are typically fundamental rather than quantitative and are generally realized around developments affecting a specific company rather than the general market.

The underlying sub-strategies may include activist, credit arbitrage, distressed/restructuring, merger arbitrage, private issue/Regulation D[16], or special situations.

Relative Value Strategies

Relative Value ("RV") strategies may invest across equity, fixed income, derivative, or other security types in order to realize an identified valuation discrepancy between securities. Managers' investment ideas may use fundamental and/or quantitative techniques. Fixed income RV strategies are typically quantitative and identify attractive opportunities based on value discrepancies or risk adjusted spreads between instruments. RV may invest in corporate transactions based on the realization of a pricing discrepancy between related securities, but as opposed to ED, these investments are not based on the outcome of a corporate transaction.

The underlying sub-strategies may include fixed income—convertible bond arbitrage, fixed income—sovereign, statistical arbitrage, option volatility arbitrage, or yield alternatives.

Hedged Equity ~~Hedge~~ Strategies

Hedged Equity ~~Hedge ("EH~~("HE") strategies maintain long and short[17] positions primarily in equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including use of both quantitative and fundamental techniques. The range of processes may include a multi-portfolio manager platform or single portfolio manager structure, a broadly diversified approach or narrow sector or thematic focus, net equity exposures from 100% short to 100% long, use of zero to high levels of leverage, short-term to multi-

[16] Regulation D securities are private placements whereby smaller companies can raise equity or debt capital without registering these securities with the Securities and Exchange Commission.

[17] "Long" positions benefit from asset price increases while "short" positions benefit from asset price decreases.

year holding periods, regional to global geographic market focus, growth to value styles, and small to large market capitalization focus.

The underlying sub-strategies may include equity market neutral, fundamental growth, fundamental value, quantitative directions, sector specific sub-strategies, or short bias.

Macro (~~Directional/~~Tactical) Strategies

Macro strategies may invest in equity, fixed income, currency, and/or commodity markets in order to benefit from ideas on economic variables and their impact on market movements, or the market movements themselves. Managers employ a variety of techniques including these: discretionary and systematic analysis, top-down and bottom-up ideas, quantitative and fundamental approaches, and long-term and short-term holding periods. Macro strategies are distinct from RV strategies in that the primary investment ideas are based on predicting future market movements rather than realizing valuation discrepancies between securities. In a similar way, while both Macro and Equity Hedge strategies may hold equities, Macro equity positions are based on investment ideas that predict market movements and their effect on security prices based on macroeconomic variables, as opposed to EH, where company fundamentals are more important for development of investment ideas.

The underlying sub-strategies may include active trading, commodity (including its subsectors of agriculture, energy, and metals), discretionary currency, systematic currency, discretionary thematic, or systematic diversified.

Hedged Credit Strategies

Hedged Credit strategies may include investment in all credit securities as well as equities, credit derivatives, sovereign bonds, commodities, currencies, or other hybrid securities. Investment ideas are based on valuation discrepancies between credit instruments, or between credit securities and other security types. Hedged Credit is distinguished from the fixed income RV strategies in that Hedged Credit includes a significant component of investment ideas based on evaluation of credit quality of underlying instruments rather than based on sovereign debt or interest rate exposures. Also, relative to fixed income RV strategies, Hedged Credit generally has more net exposure in credit markets, is less hedged, and is less leveraged.

The underlying sub-strategies may include corporate, emerging market sovereign, distressed, mezzanine debt, structured credit—residential mortgages, structured credit—commercial mortgages, other asset-backed, bank debt, direct lending, and capital structure arbitrage.

Multi-Strategy

Multi-Strategy managers invest across some or all of the five main strategy categories and may make tactical shifts among strategies at any given time. Multi-Strategy managers are not expected to have a dominant, consistent weighting to any one strategy and instead are expected to have significant investment in more than one strategy category.

ATTACHMENT 1

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

HEDGE FUNDS

2019 Hedge Funds Annual Investment Plan

September 12, 2018

TABLE OF CONTENTS

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION
HEDGE FUNDS ANNUAL INVESTMENT PLAN

INTRODUCTION

The 2019 Hedge Funds Annual Investment Plan (“HFAIP”) will guide hedge fund investment activities of the Los Angeles County Employees Retirement Association (the “Fund” or “Total Fund”) during the 2019 calendar year. It outlines the near term efforts towards meeting the long term objectives identified within LACERA’s Hedge Funds Objectives, Policies, and Procedures ("OPP").

The Fund is currently invested in diversified fund of funds, credit fund of funds, and direct hedge funds. As of June 30, 2018, approximately 2.2% of the assets of the Total Fund are allocated to Diversified Hedge Fund Investments. These are comprised of diversified fund of funds and direct hedge funds, which are below the 4% new policy allocation to Diversified Hedge Funds in the asset category Risk Mitigating and Inflation Hedges adopted by the Board in 2018. The interim target allocation to Diversified Hedge Funds Investments is proposed to be 3% as of 2Q19 and increases to 4% at the end of 2019. Separately, LACERA has 0.7% of the Total Fund invested in Credit Hedge Fund of Funds which are now part of the Credit allocation and no longer part of this Investment Plan.

This HFAIP and the OPP will guide LACERA’s investment in a direct hedge fund portfolio to reach the 4% target for Diversified Hedge Funds over the next calendar year. Much of this document addresses this plan to reach the 4% allocation target. This document sets forth a capital plan for LACERA’s Diversified Hedge Funds Investments (the “Program,” “Hedge Funds,” or “Hedge Funds Program”). Additional details on the Program are broadly outlined in LACERA’s Investment Policy Statement (“IPS”) and further detailed in the OPP, which provides the blueprint that guides the structure and administration of the Program and its underlying portfolios. The OPP also delineates the responsibilities of the Board of Investments (the "Board"), LACERA staff, the Hedge Funds Advisor(s) ("HFA"), the hedge funds portfolio administrator(s) (“Administrator”), LACERA’s custodian (“Custodian”), and LACERA’s general consultant (“General Consultant”).

SECTION I – PROGRAM OBJECTIVES

1. Introduction

   The Board has determined that, over the long term, inclusion of diversified hedge fund investments will enhance the risk/return characteristics of the Total Fund. As established in the Investment Policy Statement (“IPS”), the Hedge Funds Program has an objective to reduce the volatility of the Fund without materially decreasing Fund returns. Primarily, the Hedge Funds Program enhances the diversification of the Total Fund portfolio. This objective is achieved through investing in targeted strategies that have low to moderate correlation with public global equity returns, and have historically exhibited moderate return volatility. Hedge funds have historically had greater volatility than fixed income markets while having less than half the volatility of public global equity markets.

2. Role of Hedge Funds in the Total Fund

The IPS states that the Program objective–to reduce Fund volatility without materially decreasing Fund returns–should be measured and evaluated by the Sharpe ratio[1]. The Program is expected to improve the Sharpe ratio of the Total Fund. Even modest improvements in the Sharpe ratio benefit the Fund's ability to compound returns over the long run.

Investment decisions regarding the Program's primary objective of reducing volatility while maintaining returns are guided by the following separate objectives: (i) generating returns that exceed a target annualized return of 250 basis points[2] greater than an index of 3-month United States Treasury bills ("T-bills"), (ii) achieving realized volatility of 3-8% as measured by the annualized standard deviation of monthly returns, and (iii) maintaining a Program beta[3] of 0.25 or lower to public global equity markets as measured by the Morgan Stanley Capital International ("MSCI") All Country World Index.

3. Hedge Funds Asset Allocation

In May 2018, the Board established a long-term target allocation to diversified Hedge Funds of 4%. This allocation is part of a newly-created Risk Reduction and Mitigation asset category that also includes investment grade fixed income and cash. Previously the asset allocation target for all hedge funds, including credit hedge funds of funds was 5% of the Total Fund asset value.

Additionally, the new May 2018 policy re-categorized credit hedge fund of funds strategies, previously categorized under the Hedge Funds Program, to a new sub-category called Illiquid Credit within a new asset category named Credit. The credit hedge fund of funds portfolios comprised 0.7% of the Total Fund as of June 30, 2018. The new policy allocation to Illiquid Credit is 3%. The allocation to Illiquid Credit includes other investments apart from Credit hedge fund of funds and will be managed by the Credit team and will continue to be overseen by the Credit and Risk Mitigation Committee (formerly Fixed Income/Hedge Funds Commodities Committee).

This Plan excludes any future investments in Illiquid Credit Hedge Funds as they will be overseen via a separate allocation process managed by the Credit team which looks at Credit Hedge Funds relative to all illiquid credit opportunities. Any reference to the Diversified Hedge Funds Investments (the "Program," "Hedge Funds," or "Hedge Funds Program") herein will exclude credit hedge fund of funds investments.

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[1] Sharpe ratio is a measure of the excess return of the program over cash divided by program volatility as measured by standard deviation of returns.

[2] Subject to Board Approval. Benchmark review scheduled for September 12, 2018 BOI Meeting.

[3] Portfolio equity beta is a measurement of a portfolio's volatility relative to equity market returns. A portfolio with a beta of 1.0 has the same volatility as the equity market. Mathematically, historical beta can be viewed as the slope of the regression line of portfolio returns against market returns. The Morgan Stanley Capital International All Country World Index is used as the global equity market reference against which to measure equity beta realized by the Program.

As of June 30, 2018, the actual Hedge Funds Program allocation is 2.2% of the Total Fund[4]. As the actual allocation is currently below the long-term target allocation, which is planned to be reached in Q4 2019, an interim target allocation for Diversified Hedge Fund Investments is being recommended at the September BOI meeting to be 3.0% at the beginning of 2Q19. The Diversified Hedge Funds policy allocation is planned to change in the following quarters as shown in **Table 1** below.

Table 1
Target Hedge Funds Allocation by Quarter

Calendar Quarter	Target Diversified Hedge Funds Allocation
Current	2.2%
Q2 2019	3.0%
Q4 2019	4.0%

The Total Fund asset allocation policy in the IPS limits the actual Hedge Funds allocation to a range around the target allocation whereby the minimum allocation is the lower of 0% or 4% less than target, and the maximum allocation is 2% greater than the target. Thus, at the proposed 3% target allocation, the hedge funds allocation range is 0% to 5%. At the final 4% target allocation, the allocation range will be 0% to 6%.

4. Program Benchmark Return

A recommendation to the Board of Investments is being made at the September 2018 meeting which, consistent with the General Consultant's capital market assumptions, would make the primary Diversified Hedge Fund Program benchmark an annualized return of 250 basis points greater than an index of 3-month United States Treasury bills ("T-bills")[5]. The benchmark is used to evaluate the performance of the Program over three to seven years. When measuring realized returns against this objective, the returns are net of all fees charged by underlying hedge funds and any fund of funds managers.

Program returns are also measured against a universe of similar hedge fund strategies, as provided by a reliable third party source such as Hedge Fund Research, Inc. ("HFR"). By measuring performance over three to seven years, the Program's performance relative to a fund universe can be considered. **Table 2** identifies benchmarks for each portfolio type within the Program. A description for each portfolio follows in Section 5 of this HFAIP.

[4] $1.23 billion asset value of Hedge Funds and $56.0 billion Total Fund asset value.
[5] This benchmark has been 500 basis points greater than an index of 3-month United States Treasury bills ("T-bills") since the inception of the program.

Table 2
Fund Benchmarks by Type

Portfolio Type	Primary Benchmark	Secondary Benchmark
Diversified Hedge Fund of Funds	3 month T-bills plus 250 bps annualized[6]	HFRX Global Index[7]
Direct Hedge Funds		
Total Diversified Hedge Funds Portfolio		

5. Investment Structure

The Fund currently invests in two diversified portfolio types in the Program (hedge fund of funds and direct hedge funds).

The Fund currently deploys capital to two Hedge Fund of Fund ("HFoF") managers - Grosvenor Capital Management (“GCM”) and Goldman Sachs Asset Management (“GSAM”). GCM and GSAM each run a diversified HFoF portfolio for the Program.

GCM also runs two credit HFoF portfolios which, as previously mentioned, are categorized under the Illiquid Credit sub-category in the Credit asset category.

As the Program implementation moves forward, direct hedge fund investments are used for the advantages they provide to the Fund, namely that they are not subject to the additional layer of fees paid to fund of funds managers, they facilitate direct relationships with hedge fund managers, and they allow the Fund to have greater control over its Program.

In addition to their existing fiduciary role in investing the fund of funds portfolios, the HFoF managers have also agreed contractually to serve as HFAs, acting as a fiduciary, to support LACERA investing directly in hedge funds. The roles and responsibilities of the HFA are further described in the OPP. LACERA issued a Request for Proposal for a Consultant(s) in the Hedge Funds, Credit and Real Assets categories. When and if LACERA selects a separate Hedge Fund Consultant, the Consultant will act as an HFA.

Hedge Fund Program Portfolio Types

1. Diversified Hedge Fund of Funds: HFoF portfolio managed by an external HFoF manager who invests across hedge fund strategies. HFoF managers have discretion to construct portfolios consistent with the Hedge Fund section of LACERA’s Investment Policy Statement and any individual portfolio guidelines.

[6] Subject to BOI approval.
[7] The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies, including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset weighted. *Source: Hedge Fund Research, Inc.*

Each HFoF manager identifies, selects, and monitors these investment strategies as part of a diversified portfolio.[8]

2. Direct Hedge Funds: Diversified portfolio of hedge funds invested across hedge fund strategies, with LACERA selecting the managers and strategies. LACERA retains discretion to construct and maintain a portfolio consistent with the Program policies including the OPP and this HFAIP. As additional resources, the HFAs provide independent due diligence and technical assistance to LACERA in support of areas including market research, investment due diligence, operational due diligence, portfolio construction, and risk aggregation.

SECTION II – FUTURE INVESTMENT ACTIVITY

1. Hedge Funds Investment Pacing

The Program value and allocation as a percentage of the Total Fund are expected to increase over the coming quarters due to continued build out of the direct portfolio. LACERA began investing capital in a direct portfolio in 2018.

While these changes will result in an increase in the expected allocation to 3.0% of the Total Fund at the beginning of Q2 2019, this is below the 4.0% target hedge fund allocation at year end 2019 shown in **Table 1**.

LACERA has a target to reach a 4.0% diversified hedge fund allocation by the beginning of Q4 2019. **Table 3** summarizes expected quarterly investment pacing of the Program over the 2019 calendar year.

While this section describes a pacing model for the continued implementation of the direct hedge fund portfolio, other considerations for the Hedge Fund program priorities may also affect or delay the timing of this plan. These include the selection and implementation of a new Hedge Fund Consultant, implementation of a separately managed account platform for hedge fund strategies, market conditions, and the implementation of an emerging manager program.

[8] The Fund's contractual relationship with Goldman Sachs Asset Management regarding the diversified HFoF portfolio is through a discretionary investment management agreement rather than a fund agreement in part because those underlying funds are held directly in the Fund's name.

Table 3
Investment Pacing – Direct Hedge Funds Portfolio

Calendar Time Period	Estimated Investment in Direct Hedge Funds Portfolio	Reduction in Diversified HFoF Portfolio	Estimated Ending Value of Diversified Hedge Funds ($ millions)	% of Total Fund[9]
3Q18	$25		$1,255	2.2%
4Q18	$250		$1,505	2.7%
1Q19	$250		$1,755	3.1%
2Q19	$250		$2,005	3.6%
3Q19	$235		$2,240	4.0%
4Q19	$250	($250)	$2,240	4.0%
Aggregate 2019	$985	($250)		

2. Future Investment Structure by Portfolio Type

Table 4 shows the current allocation to the portfolio types within LACERA's Hedge Funds Program and defines the allowable allocation range for the Program. With the planned pacing described in **Table 3**, the expected allocation to the two portfolio types at the end of calendar year 2018, 2019 and 2020 is also shown in **Table 4**

The allocation to a direct portfolio is expected to move from 21% as of June 30, 2018 to 68% of the Program by the end of calendar year 2019. Diversified HFoFs are expected to decline from 79% of the Program to 32%. Allocations by portfolio type are expected to stay in the allowable allocation ranges during the next two years.

[9] Estimate based on June 30, 2018 Total Fund asset value, excluding any investment return from Hedge Funds and Total Fund subsequent to June 30, 2018.

Table 4
LACERA Hedge Fund Current And Allowable Allocations By Portfolio Type

Portfolio Type	Asset Value as of Jun 30, 2018 ($ millions)	Allocation % as of Jun 30, 2018	Estimated Dec 31, 2018 Allocation %	Estimated Dec 31, 2019 Allocation %	Allowable Allocation Range
Diversified Hedge Fund of Funds	974	79%	65%	32%	0-90%
Direct Hedge Funds	255	21%	35%	68%	0-100%
Total Program	**$1,229**	**100%**	**100%**	**100%**	

3. Investment Strategy Categories

LACERA's achievement of its Hedge Funds Program objectives requires an ability to adjust portfolio allocations across various hedge fund strategy categories since each may respond differently to prevailing market environments. The Program-level investment category constraints (shown in **Table 5)** limit strategy category exposures in order to promote diversification across strategy categories while also being flexible enough to allow for tactical shifts in and out of strategies based on their relative attractiveness and the market environment.

The constraints for each of the six investment strategy categories (defined and discussed below) are measured on a look-through basis.[10] Individual fund of fund portfolios have investment guidelines that are consistent with or more limiting than these Program-level constraints.

Definitions for the categories generally draw from the index definitions created by HFR. HFR's definitions of the first four categories in the table are objective and follow predetermined rules which place all eligible hedge funds in their Global Index into one of these four categories. However, solely using these four definitions can be limiting to broad portfolio construction, and LACERA has broadened the strategy categories to include Hedged Credit and Multi-Strategy. While the six categories are commonly used, they do not represent an exhaustive list that covers all possible hedge fund investments. The Program may invest in some funds that are not well- described by one of these strategy definitions if they otherwise meet broad objectives and constraints established for the Program

Additionally, LACERA may consider investing in "hedge fund premia" or replication-type strategies that seek to obtain systematic exposures to investment themes used

[10]Look-through basis for the Hedge Funds Program is defined as the total strategy category allocation based on the underlying portfolios in the Program, viewed independently of their portfolio structure.

by hedge funds, but at a lower cost. These strategies are expected to fall within the six strategy categories identified below.

Table 5
Diversified Hedge Funds
Investment Allocation Constraints by Strategy Category

	Strategy Constraint	Current Look-Through Allocation	Target Allocation of Direct Portfolio	Estimated Overall Allocation at year end 2019
Event Driven (excluding Credit)	Maximum 40%	12%	7.5%	11%
Relative Value	Maximum 60%	12%	15%	15%
Hedged Equity	Maximum 40%	20%	15%	20%
Macro/Tactical Trading	Maximum 50%	16%	15%	18%
Hedged Credit	Maximum 60%	11%	7.5%	10%
Multi-Strategy	Maximum 60%	29%	40%	26%

The table includes the target allocation for the direct portfolio when it is fully invested by year end 2019. The estimated strategy allocation at calendar year end 2019 is shown in the final column, with the assumption that the direct portfolio is invested at its target allocation at the end of 2019.

LACERA recognizes the opportunistic nature of investing in these strategies and will allow latitude regarding the lower and upper limits of allocation constraints and targets. In the short term, as LACERA sequentially ramps up its allocations in the direct portfolio to reach the 4% Total Fund target allocation, some individual fund allocations may cause large changes in the strategy allocation weights in the direct portfolio. Thus, these strategy constraints might not be met during the ramp up phase.

4. Portfolio Guidelines and Risk Parameters

The Hedge Fund Program and direct portfolio guidelines and risk parameters set forth in the OPP, such as liquidity, will be maintained when the direct portfolio is constructed. Program-level compliance for the portfolio guidelines and risk parameters will be reported quarterly to the Board of Investments in a section of the quarterly performance book.

5. Geographic Allocation

LACERA does not currently categorize managers by geographic concentration, as there is not a stated objective to allocate capital by region. Managers are given flexibility to invest where they find opportunity based on where they have demonstrated ability to add value, regardless of whether the region includes the United States or not. A relatively small number of managers invest solely in markets outside the U.S. Some invest on a global basis and many invest solely or mostly in U.S. markets. Staff will monitor regional and country exposures on a look-through basis so that significant unintentional regional or country exposures can be managed.

6. Manager Concentration

   Allocation limits to individual investment management organizations or funds are set by guidelines for the hedge fund of funds managers. For the Direct Hedge Funds portfolio, investment in an individual fund is limited to 20% of the market value of the direct portfolio.

SECTION III – 2018 INVESTMENT ACTIVITY

1. Calendar Year 2018 Investment Activity

   LACERA has invested $285 million in three separate direct hedge funds through August 2018.This portfolio is described in the regular quarterly Hedge Fund reporting and new fund cash flows are included in the monthly CIO letter.

SECTION IV – NEAR TERM AND FUTURE PRIORITIES

1. Near Term and Future Priorities

   This HFAIP and the OPP recommend a pace of investing that will result in reaching the 4% target allocation by beginning of Q4 2019. Much of the capital pacing in this HFAIP reflects allocations to newly approved managers to build up the direct hedge fund portfolio.

   After the full 4% strategic target allocation to Hedge Funds is reached (expected by Q4 2019), allocations will be moved from diversified hedge fund of funds to direct hedge funds, so that each diversified hedge fund of funds portfolio will be reduced to an approximate net asset value of $250 million. $250 million was the initial amount allocated to each HFoF manager at their inception. Such an allocation is expected to maintain the level of services required to support their role as a Hedge Fund Advisor. Beyond 2019, approximately 22% of the Program would be in diversified HFoFs after LACERA reaches its 4% strategic allocation target and after the diversified HFoFs are brought down to $250 million each.[11]

   Once each diversified HFoF portfolio is brought down to approximately $250 million, LACERA may re-evaluate the role of its HFoF managers. At that time, LACERA may consider alternative structures for the Program that eliminate one or both HFoF managers. LACERA is currently soliciting for the retention of a HFA that acts in a

[11] Based on current total fund asset value of $56 billion.

purely advisory capacity which provides flexibility to eliminate one or both diversified funds of funds structures entirely if desired.

LACERA may also consider alternatives to the current mandates for the fund of funds managers. For example, LACERA may wish to consider changing the mandates to be more targeted to a specific strategy, manager profile, or geographic region where a fund of funds manager may be better resourced than LACERA to accomplish.

In 2019, LACERA will also explore strategies through Committee and Board discussions for constructing an emerging manager hedge fund portfolio. Such strategies may include converting all or a portion of an existing Diversified HFoF portfolio mandate to an Emerging Manager HFoF portfolio mandate or working with a new non-discretionary HFA to build a direct Hedge Fund Emerging Manager Program. This portfolio would follow new policies and objectives for emerging manager portfolios that already exist in LACERA's other asset categories.

SECTION V – MARKET OUTLOOK

1. Market Outlook

The following pages describe the current outlook for hedge fund strategies from LACERA's hedge fund advisors, GSAM and GCM. Neither HFA currently expresses a significant view towards or against any individual hedge fund strategy category. LACERA will generally invest in a balanced manner across the various strategies including multi-strategy managers who have the ability to invest tactically across strategies.

GSAM's current market outlook includes mainly neutral views across hedge funds with positive views for select sub strategies in tactical trading, including trading monetary policy, emerging markets and volatility. Their view is neutral overall for event driven strategies, most segments of the credit markets, and equity long/short.

Grosvenor's market outlook and investment focus includes strategic allocations across all major strategy categories with volatility trading the most favorable. Their views are mixed/neutral for equities and commodities/currency trading. Their views are mixed/unfavorable for credit and rates trading.

Public Equities and Equity Long / Short Outlook

Rising stock correlations and EPS growth remain in focus

Goldman Sachs Asset Management

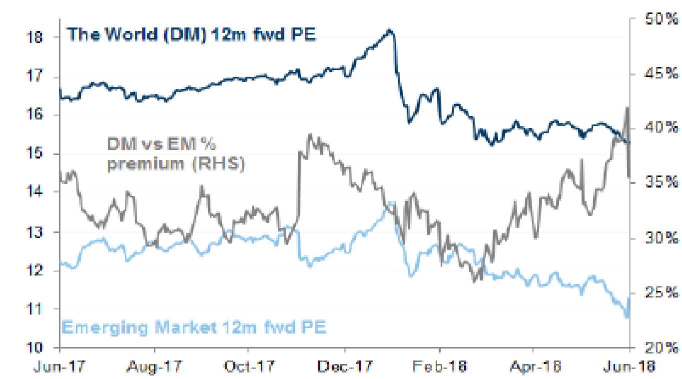
AIMS outlook

- Neutral outlook for equity long/short managers on both the alpha generation and equity beta opportunity; volatility and stock correlations have fallen back from high levels in Q1'18
- Prefer managers with more balanced net exposure and diversified, less-crowded alpha drivers, rather than directional managers in crowded hedge fund themes; when taking equity beta we favor high quality/secular growth biased exposure
- Neutral view on long-only equities driven by a more positive view on international equities due to improved earnings growth and relatively cheap valuations; more constructive on Emerging Markets equities

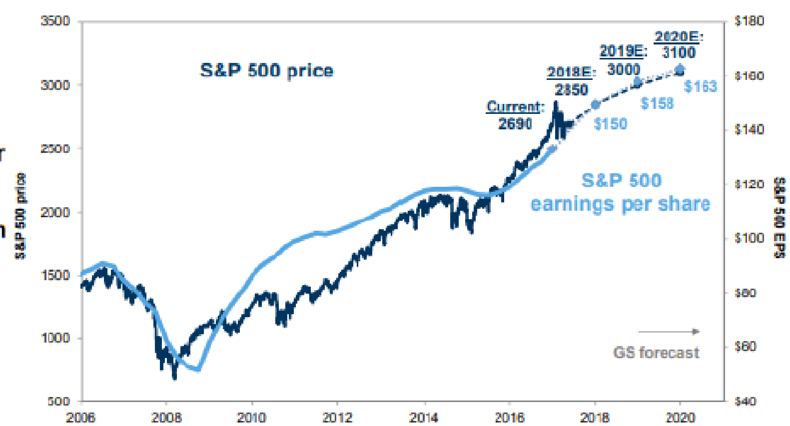
Top 5 potentially investable themes

1. **Rising rates potential tailwind for active management –** Improving opportunity set for shorting and a driver of higher stock price dispersion
2. **Positive signals outside of the US** – Cheaper valuations and constructive economic indicators provide a fruitful environment for stock picking
3. **Narrow valuation dispersion and modest economic growth in the US** – Could support further outperformance of growth
4. **Attractive entry point for MLPs** – Valuations and fundamentals remain supportive
5. **Potential long/short opportunities in therapeutics healthcare** – Supportive fundamental, regulatory, and capital market forces coupled with evolving research and technology

EM trading at higher than average discount to DM[1]



Earnings: S&P 500 earnings and index targets[1]



Source: AIMS Group, Morningstar Bloomberg, MSCI. As of June 2018. [1] Source: GIR. As of June 2018. For illustrative purposes only. Past correlations are not indicative of future correlations, which may vary. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice. Investors cannot invest directly in indices.

Event Driven & Credit Hedge Funds Outlook

Maintain neutral outlook for merger arb & multi-strategy

Goldman Sachs Asset Management

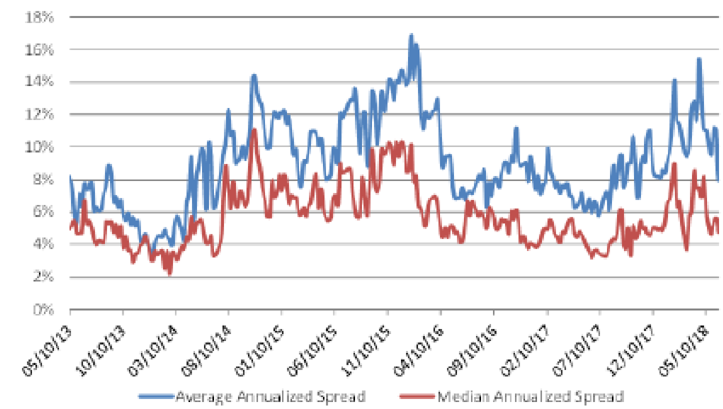
AIMS outlook

- Maintain overall neutral outlook for event driven strategies. Most notably, we have maintained our neutral outlook for merger arbitrage as spreads on vertical and media-related mergers have rallied, offsetting the perceived reduced regulatory risk
- We believe the current environment will favor managers with strong deal underwriting capabilities as we have observed a divergence in merger spreads between perceived safe deals and those with higher risk of regulatory intervention
- We maintain a neutral outlook for most segments of the credit market, focusing our investments on segments of the market offering correlation benefits (e.g., structured credit, insurance)

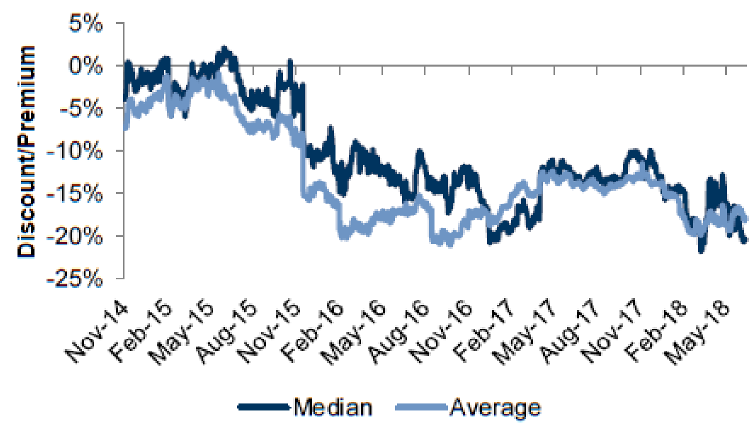
Top 5 potentially investable themes

1. **Event driven** – "Stub trades"[4] have the potential to offer idiosyncratic returns, with US tax reform serving as a catalyst for spread compression
2. **Distressed opportunities** – While the proportion of bonds and loans trading at stressed/distressed levels remains low, there are still select opportunities in retail, telecom and energy.
3. **Structured / ABS** – Asymmetric way to implement bearish retail view, specifically on Class B/C malls, via CMBX shorts
4. **Structured / RMBS** – The credit cycle for housing is much younger than for corporate credit, supporting the risk-adjusted opportunities in legacy non-agency RMBS and Agency CRTs
5. **Growth & emerging markets** – Relatively attractive carry and risk-adjusted return potential, particularly in select LatAm markets

Annualized merger arb spreads[1] remain modest but volatile[2]



Premium / Discount of HoldCos to Listed Subsidiaries[3]



Source: AIMS Group, Barclays, Bloomberg. As of June 2018. [1](0%- 50% annualized). [2]Source: Bloomberg, UBS Special Situations. As of June 15, 2018. [3]Source: Bloomberg. Includes 4-9 different commonly held stub trades. For illustrative purposes only. Past performance does not guarantee future results, which may vary. Past correlations are not indicative of future correlations, which may vary. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice. Investors cannot invest directly in indices. [4]Capturing the spread between the share price of listed holding companies and their listed subsidiaries.

Tactical Trading Outlook

Attractive opportunities to trade monetary policy, emerging markets and volatility

Goldman Sachs Asset Management

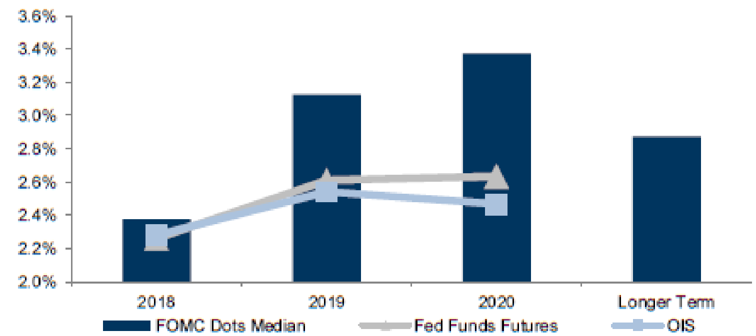
AIMS outlook

- Monetary policy normalization and higher volatility could present opportunities for tactical trading managers as rates rise and QE unwinds
- However, the gap between views and market pricing is now mostly further out on the curve, making potential exogenous shocks from trade and geopolitics more challenging to trade.
- Emerging markets offer long/short opportunities with managers still finding attractive niche areas. Valuations have improved but higher US rates, a stronger US dollar and upcoming elections could pose challenges.

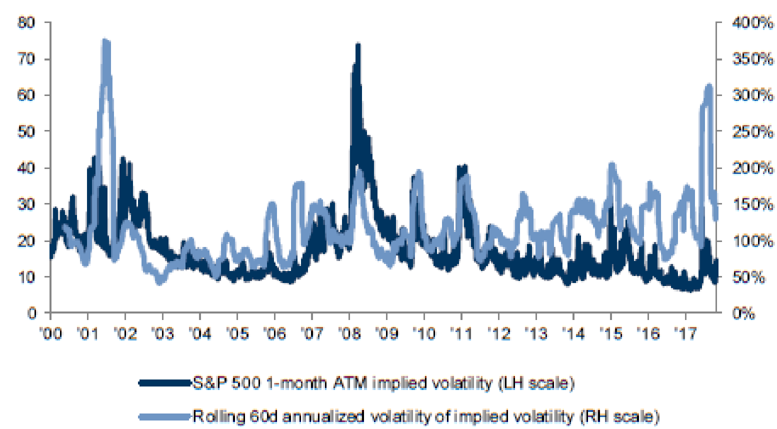
Top 5 potentially investable themes

1. **Fixed income** – changing supply and demand dynamics with relative progress of central bank tightening and transition may create opportunities for RV and directional trading
2. **EM** - managers are finding niche opportunities, as idiosyncratic events may be mispriced. Differing monetary policies and political cycles can create long/short opportunities.
3. **Volatility** – with implied and realized vol remaining close to historical lows, there may be opportunities for long-biased volatility trading and thoughtful tail risk managers
4. **US fiscal policy** – fiscal stimulus could have significant growth and monetary policy implications
5. **FX** – Central bank tightening may increase yield differentials and impact trade and flows, with opportunities in DM and EM

Markets are pricing fewer hikes than the Fed dot plot[1]



Volatility has picked up after hitting all-time lows in 2017[2]



Sources: AIMS Group, Morningstar Bloomberg, MSCI. As of June 2018 . [1] Source: Bloomberg. As of June 2018. [2] Sources: GSAM, Bloomberg. As of June 2018 For illustrative purposes only. Past correlations are not indicative of future correlations, which may vary. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice. Investors cannot invest directly in indices.

Market Factor Review and Outlook

3rd Quarter 2018 (1 of 2)

Factor / Outlook	Views
Economic factors Mixed/Unfavorable	▪ While the global economic expansion is expected to continue through 2019, with global real GDP estimated to increase by 3.90% in both 2018 and 2019, there are mounting risks to the economic outlook. Economic growth has not only peaked across a number of major economies, but growth has also become more uneven among both developed and emerging market economies.[1] ▪ The US Federal Reserve is expected to continue tightening monetary conditions after raising interest rates in June for the third time in as many quarters. The Fed's June dot plot indicated an expectation of two additional rate hikes in 2018, increasing its total number of projected interest rate hikes to four in 2018. ▪ The Trump administration's threat to impose tariffs on $500 billion worth of Chinese imports raised fears of a prolonged trade war between the world's two largest economies. ▪ Increased trade tensions risk undermining the global economy and devolving into a full-fledged currency war. ▪ November's midterm Congressional elections and their potential impact on the US political landscape and Trump's legislative agenda. ▪ With less than one year remaining until Brexit takes effect in March 2019, UK and EU officials continue to negotiate the terms of a withdrawal treaty. The prospect of a "soft Brexit" led to a number of high profile resignations from Theresa May's cabinet, including Foreign Secretary Boris Johnson and chief Brexit negotiator David Davis. ▪ The Five Star Movement and League political parties in Italy are viewed as anti-Euro, and despite somewhat softened rhetoric regarding a potential Italian exit from the EU, risks in the region are elevated. ▪ Concerns regarding elevated equity valuations and potential disruptions from ongoing reforms temper an otherwise positive outlook for India. ▪ Easing tensions on the Korean peninsula and the Bank of Japan's commitment to its negative interest rate policy contributed to yen weakness.
Credit Mixed/Unfavorable	▪ While credit spreads have widened somewhat from Q1's historically tight levels, spreads remain reasonably tight and there have not yet been dislocations that create significant directional credit opportunities. ▪ Treasury yields closed Q2 at their highest levels since 2011 as the unemployment rate reached its lowest level since 1999. ▪ Spreads in the BBB market remain historically tight relative to US Treasuries. ▪ Heightened interest rate sensitivity continues to persist in the HY market. ▪ EM credit faces acute challenges driven by both global macroeconomic issues (trade and rates) and idiosyncratic missteps in individual markets (most notably in Argentina, Venezuela, and Turkey). ▪ The global bond selloff continued in Q2 as central banks hinted at ending easy-money policies in the face of a stronger global recovery.

1 International Monetary Fund, World Economic Outlook. April 2018.

Market Factor Review and Outlook

3rd Quarter 2018 (2 of 2)

Factor / Outlook	Views
Equities Mixed/ Neutral	▪ Global equities climbed higher in Q2 2018, with the S&P 500 and Russell 2000 rising 3.43% and 7.43%, respectively. ▪ The Shiller P/E ratio remains at its highest level since 2001. ▪ Emerging markets saw large losses in Q2 with the MSCI Emerging Markets Index down -7.86%. Outlook is for wider-than-historical dispersion.
Volatility Favorable (higher)	▪ After spiking in Q1 to its highest level since 2015, the VIX steadily declined to its historical average in Q2. For the year, volatility continues to recover from the historic lows observed in 2017. ▪ Divergences in global central bank policies may continue to increase volatility. ▪ Volatility is expected to continue in the coming months due to concerns over the economic factors listed above.
Rates Mixed /Unfavorable	▪ The ECB and the Bank of Japan currently have large-scale monetary easing policies in place. ▪ The ECB announced in June that it will end its monthly asset purchasing program after December 2018 and that it will hold interest rates unchanged through at least Q2 2019. ▪ The US Federal Reserve expects to raise interest rates four times in 2018.
Commodities/ currencies Mixed/ Neutral	▪ The US Dollar appreciated against a basket of global currencies in Q2 2018. ▪ We expect continued volatility as central bank policies continue to influence currency trends. ▪ Geopolitical tensions drove oil prices up over 11% in Q2 to a nearly four-year high of $72 per barrel.

Data sources: Bloomberg; Financial Times. MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI; S&P. S&P and its third-party information providers do not accept liability for the information and the context from which it is drawn.

Unless apparent from context, all statements herein represent GCM Grosvenor's opinion. No assurance can be given that any investment will achieve its objective or avoid losses.

GCM GROSVENOR

SUMMARY STATEMENT

This document outlines the near term capital plan for LACERA's Hedge Fund Program as its structure transitions from one invested primarily in discretionary diversified fund of funds to one which primarily consists of direct hedge fund investments. Subject to future modifications by the Board, this document establishes the investment pacing for the Program over the next calendar year as LACERA increases its investment in hedge funds to reach its 4% strategic allocation target (which is expected by the beginning of Q4 2019).

This Investment Plan will be updated annually to meet the evolving needs of the Hedge Fund Program. Updates concerning progress or meaningful challenges will be communicated or discussed with the Risk Reduction and Mitigation Asset Committee or Board, as appropriate.

APPENDIX

Descriptions of six main Hedge Fund Strategy Categories

Event Driven Strategies

Event Driven ("ED") strategies invest in securities of companies undergoing or expected to undergo corporate transactions, including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance, or other capital structure adjustments. Security types may include equities; senior, junior, or subordinated debt; and derivatives. ED investments may include exposure to equity markets, credit markets, and idiosyncratic, company-specific developments. Investment ideas are typically fundamental rather than quantitative and are generally realized around developments affecting a specific company rather than the general market.

The underlying sub-strategies may include activist, credit arbitrage, distressed/restructuring, merger arbitrage, private issue/Regulation D[12], or special situations.

Relative Value Strategies

Relative Value ("RV") strategies may invest across equity, fixed income, derivative, or other security types in order to realize an identified valuation discrepancy between securities. Managers' investment ideas may use fundamental and/or quantitative techniques. Fixed income RV strategies are typically quantitative and identify attractive opportunities based on value discrepancies or risk adjusted spreads between instruments. RV may invest in corporate transactions based on the realization of a pricing discrepancy between related securities, but as opposed to ED, these investments are not based on the outcome of a corporate transaction.

The underlying sub-strategies may include fixed income—convertible bond arbitrage, fixed income—sovereign, statistical arbitrage, option volatility arbitrage, or yield alternatives.

Hedged Equity Strategies

Hedged Equity ("HE") strategies maintain long and short[13] positions primarily in equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including use of both quantitative and fundamental techniques. The range of processes may include a multi-portfolio manager platform or single portfolio manager structure, a broadly diversified approach or narrow sector or thematic focus, net equity exposures from 100% short to 100% long, use of zero to high levels of leverage, short-term to multi-year holding periods,

[12] Regulation D securities are private placements whereby smaller companies can raise equity or debt capital without registering these securities with the Securities and Exchange Commission.

[13] "Long" positions benefit from asset price increases while "short" positions benefit from asset price decreases.

regional to global geographic market focus, growth to value styles, and small to large market capitalization focus.

The underlying sub-strategies may include equity market neutral, fundamental growth, fundamental value, quantitative directions, sector specific sub-strategies, or short bias.

Macro (Tactical) Strategies

Macro strategies may invest in equity, fixed income, currency, and/or commodity markets in order to benefit from ideas on economic variables and their impact on market movements, or the market movements themselves. Managers employ a variety of techniques including these: discretionary and systematic analysis, top-down and bottom-up ideas, quantitative and fundamental approaches, and long-term and short-term holding periods. Macro strategies are distinct from RV strategies in that the primary investment ideas are based on predicting future market movements rather than realizing valuation discrepancies between securities. In a similar way, while both Macro and Equity Hedge strategies may hold equities, Macro equity positions are based on investment ideas that predict market movements and their effect on security prices based on macroeconomic variables, as opposed to EH, where company fundamentals are more important for development of investment ideas.

The underlying sub-strategies may include active trading, commodity (including its subsectors of agriculture, energy, and metals), discretionary currency, systematic currency, discretionary thematic, or systematic diversified.

Hedged Credit Strategies

Hedged Credit strategies may include investment in all credit securities as well as equities, credit derivatives, sovereign bonds, commodities, currencies, or other hybrid securities. Investment ideas are based on valuation discrepancies between credit instruments, or between credit securities and other security types. Hedged Credit is distinguished from the fixed income RV strategies in that Hedged Credit includes a significant component of investment ideas based on evaluation of credit quality of underlying instruments rather than based on sovereign debt or interest rate exposures. Also, relative to fixed income RV strategies, Hedged Credit generally has more net exposure in credit markets, is less hedged, and is less leveraged.

The underlying sub-strategies may include corporate, emerging market sovereign, distressed, mezzanine debt, structured credit—residential mortgages, structured credit—commercial mortgages, other asset-backed, bank debt, direct lending, and capital structure arbitrage.

Multi-Strategy

Multi-Strategy managers invest across some or all of the five main strategy categories and may make tactical shifts among strategies at any given time. Multi-Strategy managers are not expected to have a dominant, consistent weighting to any one strategy and instead are expected to have significant investment in more than one strategy category.

ATTACHMENT 2

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

HEDGE FUNDS

Objectives, Policies, and Procedures

September 12, 2018

HEDGE FUNDS OBJECTIVES, POLICIES, and PROCEDURES

TABLE OF CONTENTS

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION
HEDGE FUNDS OBJECTIVES, POLICIES, AND PROCEDURES

DOCUMENT PURPOSE

The Hedge Funds Objectives, Policies, and Procedures ("OPP") document sets forth in further detail certain elements of LACERA’s Diversified Hedge Funds Investment Program (the “Program,” “Hedge Funds,” or “Hedge Funds Program”) which are broadly outlined in LACERA’s Investment Policy Statement (“IPS”). The OPP defines the Program’s objectives and high level parameters, stipulates the detailed policies that govern the Program, establishes risk management practices, spells out the procedures to be followed, and delineates the responsibilities of the Board of Investments (the "Board"), LACERA staff ~~(“Staff”),~~, the Hedge Funds Advisor(s) ("HFA"), the hedge funds portfolio administrator(s) (“Administrator”), LACERA’s custodian (Custodian”), and LACERA’s general consultant (“General Consultant”). In essence, the OPP provides the blueprint that guides the structure and ~~administration~~implementation of the Program and its underlying portfolios.

SECTION I – PROGRAM OBJECTIVES

1. Introduction

The Board ~~of Investments of the Los Angeles County Employees Retirement Association (the “Fund” or “Total Fund”)~~ has determined that, over the long term, inclusion of diversified hedge fund investments will enhance the risk/return characteristics of the Total Fund. ~~The~~ As established in the Investment Policy Statement “IPS”, the Hedge Funds ~~Investment~~ Program has an objective to reduce the volatility of the Fund without materially decreasing Fund returns. Primarily, the Hedge Funds Program enhances the diversification of the Total Fund portfolio. This objective is achieved through investing in targeted strategies that have ~~historically had~~ low to moderate correlation with public global equity returns, and have historically exhibited moderate return volatility. Hedge funds have historically had greater volatility than fixed income markets while having less than half the volatility of public global equity markets.

2. Role of Hedge Funds in the Total Fund

~~LACERA’s~~

The IPS states that the Program objective–to reduce Fund volatility without materially decreasing Fund returns–should be measured and evaluated by the Sharpe ratio[1]. The Program is expected to improve the Sharpe ratio of the Total Fund. Even modest improvements in the Sharpe ratio benefit the Fund’s ability to compound returns over the long run.

Investment decisions regarding the Program’s primary objective of reducing volatility while maintaining returns are guided by the following separate objectives: (i) generating returns that exceed a target annualized return of ~~500~~250 basis points[2] greater than an index of 3-month United States Treasury bills~~,~~ ("T-bills"), (ii) achieving realized volatility of ~~5~~3-8% as measured by the annualized standard deviation of monthly returns, and (iii) maintaining a Program beta of 0.25 or lower to public global

[1]Sharpe ratio is a measure of the excess return of the program over cash divided by program volatility as measured by standard deviation of returns.
[2] Subject to Board approval. Benchmark review scheduled for September 12, 2018 BOI Meeting.

equity markets as measured by the Morgan Stanley Capital International ("MSCI") All Country World Index.

3. Hedge Funds Asset Allocation

~~The~~

In May 2018, the Board established a long-term target allocation to ~~the~~diversified Hedge Funds ~~Program~~of 4%. This allocation is part of a newly-created Risk Reduction and Mitigation asset category that also includes investment grade fixed income and cash. Previously the asset allocation target for all hedge funds, including credit hedge funds of funds was 5% of the Total Fund asset value. ~~This 5% target allocation was established by the Board in October 2015. Since Program inception in 2011, the Board has approved several~~

Additionally, the new May 2018 allocation policy re-categorized credit hedge fund of funds strategies, previously categorized under the Hedge Funds Program, to a new sub-category called Illiquid Credit within a new asset category named Credit. The credit hedge fund of funds portfolios ~~that are~~ comprised 0.7% of the Total Fund as of June 30, 2018. The new policy allocation to Illiquid Credit is 3%. The allocation to Illiquid Credit includes other investments apart from Credit hedge fund of funds and will be managed by ~~external fund of funds managers.~~ the Credit team and will continue to be overseen by the Credit and Risk Mitigation Committee (formerly Fixed Income/ Hedge Funds/ Commodities Committee).

Any reference to the Diversified Hedge Funds Investments (the "Program," "Hedge Funds," or "Hedge Funds Program") herein will exclude credit hedge fund of funds investments.

As of June 30, ~~2017~~2018, the actual Hedge Funds Program allocation is 2.~~7% of the Total Fund[3]. Additionally, there remained $6 million of approved but unfunded[4] commitments to Hedge Funds that are expected to be funded by third calendar quarter of 2017. This unfunded commitment represents 0.01~~2% of the Total Fund ~~asset value.~~[5]. As the actual allocation is currently below the long-term target allocation, which is planned to be reached in Q4 ~~2018,~~2019, an interim target ~~allocations~~allocation for Diversified Hedge Fund Investments is being recommended at the September 2018 BOI meeting to be 3.0% at the beginning of 2Q19. The Diversified Hedge Funds ~~have been developed and approved by the Board as part of the implementation plan for the 2015 Total Fund asset allocation~~ policy. ~~The Hedge Funds~~ allocation is planned to ~~increase incrementally each quarter~~change in the following quarters as shown in ~~the table~~**Table 1** below.

[3] ~~$1.4 billion asset value of Hedge Funds and $ 52.5 billion Total Fund asset value.~~
[4] ~~Capital committed by LACERA but not yet invested by the HFoF manager.~~
[5] $1.23 billion asset value of Hedge Funds and $56.0 billion Total Fund asset value.

Table 1
Target Hedge Funds Allocation by Quarter

Calendar Quarter	Target Diversified Hedge Funds Allocation
Current	~~3.4~~2.2%
~~Q4 2017~~Q2 2019	~~4.2~~3.0%
Q4 ~~2018~~2019	~~5~~4.0%

~~In addition to the target allocation percentages, the~~The Total Fund asset allocation policy in the IPS limits the actual Hedge Funds allocation to a range ~~of 3%~~ around the target allocation whereby the minimum allocation is the lower of 0% or 4% less than target, and the maximum allocation is 2% greater than the target~~ allocation. ~~. Thus, at the ~~current~~proposed 3~~.4~~% target allocation, the hedge funds allocation range is 0~~.4~~% to 5~~.4%.~~%. At the final 4% target allocation, the allocation range will be 0% to 6%.

4. Program Objectives and Parameters

4.1 Program Benchmark Return

~~To evaluate the performance of the Program,~~

A recommendation to the Board of Investments is being made at the September 2018 BOI meeting which, consistent with the General Consultant's capital market assumptions, would make the primary Diversified Hedge Fund Program benchmark ~~is the~~an annualized return of 250 basis points greater than an index of 3-month United States Treasury ~~Bills plus 5% per annum,~~bills ("T-bills")[6]. The benchmark is used to evaluate the performance of the Program over three to seven years.~~ ~~When measuring realized returns against this objective, the returns are net of all fees charged by underlying hedge funds and any fund of funds managers.

Program returns are also measured against a universe of similar hedge fund strategies, as provided by a reliable third party source such as Hedge Fund Research, Inc. ("HFR"). By measuring performance over three to seven years, the Program's performance relative to a fund universe can be considered. **Table 2** identifies benchmarks for each portfolio type within the Program. A description for each portfolio follows in Section 5 of this HFAIP.

[6] This benchmark has been 500 basis points greater than an index of 3-month United States Treasury bills ("T-bills") since the inception of the program.

Table 2
Fund Benchmarks by Type

~~PortfolioType~~Portfolio Type	~~After Fee~~ Primary Benchmark	~~After Fee~~ Secondary Benchmark
Diversified Hedge Fund of Funds	3 month T-bills plus ~~500~~250 bps annualized[7]	HFRX Global Index8
~~Credit Hedge Fund of Funds~~		~~HFRX Fixed Income–Credit Index~~[9]
Direct Hedge Funds~~[10]~~		~~HFRX Global Index~~
Total Diversified Hedge Funds Portfolio		~~HFRX Global Index~~

4.2 Program Parameters

The Diversified Hedge Funds Program is expected to have volatility greater than that of fixed income markets but less than that of public equity markets, generally at a level of less than half of public equity market volatility. Realized volatility, as measured by standard deviation of returns, is expected to range from 3-8% over three-year rolling time periods. The program is expected to have low to moderate correlation with public global equities and will be managed by maintaining a portfolio equity beta[11] of 0.25 or lower.

5. Investment Structure

The Fund currently invests in two diversified portfolio types in the Program (~~diversified~~ hedge fund of funds and ~~credit hedge fund of funds), and will be adding a third portfolio type (~~direct hedge funds).

The Fund currently deploys capital to two Hedge Fund of Fund ("HFoF") managers ~~to invest in the two existing portfolio types. The first manager,~~ Grosvenor Capital

[7] Subject to BOI approval.

[8]The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies, including but not limited to convertible arbitrage, distressed securities, hedged equity ~~hedge~~, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset weighted. *Source: Hedge Fund Research, Inc.*

~~[9]The HFRX Fixed Income–Credit Index includes strategies with exposure to credit across a broad continuum of credit sub-strategies, including corporate, sovereign, distressed, convertible, asset backed, capital structure arbitrage, multi-strategy and other relative value and event driven sub-strategies.~~ ~~*Source: Hedge Fund Research, Inc.*~~

~~[10]Direct hedge funds portfolio is yet to be invested. See Section III.1 Capital Planning.~~

[11]Portfolio equity beta is a measurement of a portfolio's volatility relative to equity market returns. A portfolio with a beta of 1.0 has the same volatility as the equity market. Mathematically, historical beta can be viewed as the slope of the regression line of portfolio returns against market returns. The Morgan Stanley Capital International All Country World Index is used as the global equity market reference against which to measure equity beta realized by the Program.

Management ("GCM~~"), runs~~ ") and Goldman Sachs Asset Management ("GSAM"). GCM and GSAM each run a diversified HFoF portfolio ~~and~~ for the Program. GCM also runs two credit HFoF portfolios~~. The second manager, Goldman Sachs Asset Management ("GSAM"), runs a diversified HFoF portfolio.~~ which are categorized under the Illiquid Credit sub-category in the Credit asset category.

As the Program implementation moves forward, direct hedge fund investments ~~will be~~are used for the advantages they provide to the Fund, namely that they are not subject to the additional layer of fees paid to fund of funds managers, they facilitate direct relationships with hedge fund managers, and they allow the Fund to have greater control over its Program.

In addition to their existing fiduciary role in investing the fund of funds portfolios, the HFoF managers have also agreed contractually to serve as HFAs, acting as a fiduciary, to support LACERA ~~directly~~ investing directly in hedge funds. ~~The HFAs will provide these services as a fiduciary.~~ The roles and responsibilities of the HFA are further described in ~~section IV of this~~the OPP. LACERA issued a Request for Proposal for a Consultant(s) in the Hedge Funds, Credit and Real Assets categories. When and if LACERA selects a separate Hedge Fund Consultant, the Consultant will act as an HFA.

Hedge Fund Program Portfolio Types

1. Diversified Hedge Fund of Funds: HFoF portfolio managed by an external HFoF manager who invests across ~~major~~ hedge fund strategies.~~ ~~ HFoF managers have discretion to construct portfolios consistent with the Hedge Fund section of LACERA's Investment Policy Statement and any individual portfolio guidelines. Each HFoF manager identifies, selects, and monitors these investment strategies as part of a diversified portfolio.[12]
2. ~~Credit Hedge Fund of Funds: HFoF portfolio managed by an external HFoF manager that invests primarily in credit strategies. These strategies typically are oriented to longer-term investments and require capital lock-up periods of one to five years, generally longer than those in the Diversified HFoF. These are held in limited-life vehicles whereby substantially all of the capital is expected to be returned within the limited life of the vehicle.~~

~~3.~~2. Direct Hedge Funds: ~~Portfolio~~ Diversified portfolio of hedge funds invested across ~~major~~ hedge fund strategies, with LACERA selecting the ~~hedge funds.~~ managers and strategies. LACERA retains discretion to construct and maintain a portfolio consistent with the Program policies including the OPP and this ~~OPP.~~ HFAIP. As additional resources, the HFAs provide independent due diligence and technical assistance to LACERA in support of areas including market research, ~~manager~~investment due diligence, operational due diligence, portfolio construction, and risk aggregation.

[12]The Fund's contractual relationship with Goldman Sachs Asset Management regarding the diversified HFoF portfolio is through a discretionary investment management agreement rather than a fund agreement in part because those underlying funds are held directly in the Fund's name.

~~The table on page 5~~

Table 3 shows the current allocation to the portfolio types among LACERA's ~~entire~~ Hedge Funds Program and defines the allowable allocation range for the Program. ~~As of yet,~~

Table 3

LACERA ~~has not begun investing in a direct hedge fund portfolio.~~**Hedge Funds Program**

~~**LACERA HEDGE FUND**~~
~~**CURRENT AND ALLOWABLE ALLOCATION BY PORTFOLIO TYPE**~~
Current and Allowable Allocation By Portfolio Type

Portfolio Type	~~**Net Asset Value as of June 30, 2017 ($ million)**~~	~~**Allocation %**~~	**Allowable Allocation Range**
Diversified Hedge Fund of Funds[13]	~~919~~	~~64%~~	~~15~~0-90%
~~Credit Hedge Fund of Funds~~	~~524~~	~~36%~~	~~10-45%~~
Direct Hedge Funds	~~0~~	~~0%~~	0-~~75~~100%
Total Program	~~**$1,443**~~	~~**100%**~~	

~~Note: If all $6 million in unfunded commitments to the credit HFoF was funded and added to the existing Program, the credit HFoF would be 37% of the total Hedge Funds Program and the diversified HFoF would be 63% of the Program.~~

6. Investment Strategy Categories

LACERA's achievement of its Hedge Funds Program objectives requires an ability to adjust portfolio allocations across various hedge fund strategy categories~~,~~ since each may respond differently to prevailing market environments ~~differently.~~. The Program-level investment category constraints (~~page 6~~shown in **Table 4)** limit strategy category exposures in order to promote diversification across ~~-~~ strategy categories while also being flexible enough to allow for tactical shifts in and out of strategies based on their relative attractiveness and the market environment.

[13] When invested to reach the ~~5~~4% strategic asset allocation Total Fund target, ~~20~~22% of the Hedge Funds Program would be approximately $500 million (at a $~~50~~56 billion Total Fund valuation). LACERA's initial allocation to its two HFoF managers was $250 million each. This minimum level of investment is necessary for LACERA to continue to receive HFA services as part of its agreements with the HFoF managers. ~~20~~Approximately 22% of the Program is the longer-term target for the diversified HFoFs after LACERA reaches its ~~5~~4% strategic allocation target.

The constraints for each of the six investment strategy categories (defined and discussed below) are measured on a look-through basis[14]~~. Additionally, individual.~~[15] Individual fund of fund portfolios have investment guidelines that are consistent with or more limiting than these Program-level constraints.

Definitions for the categories generally draw from the index definitions created by HFR. ~~-~~HFR's definitions of the first four categories ~~below~~in the table are objective and follow predetermined rules which place all eligible hedge funds in their Global Index into one of these four categories. ~~-~~However, solely using these four definitions ~~are~~can be limiting to broad portfolio construction, and LACERA has broadened the strategy categories to include Hedged Credit and Multi-Strategy.~~-~~ While the six categories are commonly used, they do not represent an exhaustive list that covers all possible hedge fund investments. ~~–~~The Program may invest in some funds that are not well ~~categorized~~ described by one of these ~~strategies~~strategy definitions if they otherwise meet ~~the other~~broad objectives and constraints established for the Program.

Additionally, LACERA may consider investing in "~~alternative beta~~hedge fund premia" or replication-type strategies that seek to obtain systematic exposures to investment themes used by hedge funds~~ or market exposures~~, but at a lower cost. ~~–~~These strategies are expected to fall within the six strategy categories ~~shown~~identified below.

~~TOTAL PROGRAM~~

Table 4

Diversified Hedge Funds Investment Allocation Constraints by Strategy Category

Strategy	Strategy Constraint	Target Allocation of Direct Portfolio
Event Driven (excluding Hedged Credit)	Maximum 40%	7.5%
Relative Value	Maximum 60%	15%
Hedged Equity ~~Hedge~~	Maximum 40%	15%
Macro~~ (Directional~~/Tactical~~)~~ Trading	Maximum 50%	15%
Hedged Credit	Maximum 60%	7.5%
Multi-Strategy	Maximum 60%	40%

The table includes the target allocation for the direct portfolio when it is fully invested by year end 2019.

~~[14]Look-through basis for the Hedge Funds Program is defined as the total strategy category allocation throughout all the underlying portfolios in the Program, viewed independently of their portfolio structure.~~

[15]Look-through basis for the Hedge Funds Program is defined as the total strategy category allocation based on the underlying portfolios in the Program, viewed independently of their portfolio structure.

LACERA recognizes the opportunistic nature of investing in these strategies and will allow ~~Staff and the HFoF managers some~~ latitude ~~outside~~regarding the lower and upper limits of ~~the ranges.~~ allocation constraints and targets. In the short term, as LACERA ~~builds~~sequentially ramps up its allocations in the direct portfolio to reach the ~~5%~~4% Total Fund target allocation, some individual fund allocations may cause ~~material~~large changes in the strategy allocation weights in the direct portfolio. Thus, these strategy constraints ~~may~~might not be met ~~while the direct portfolio is being constructed through~~during the ~~fourth quarter of 2018.~~ ramp up phase.

6.1 Event Driven Strategies

Event Driven ("ED") strategies invest in securities of companies undergoing or expected to undergo corporate transactions, including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance, or other capital structure adjustments. Security types may include equities; senior, junior, or subordinated debt; and derivatives. ED investments may include exposure to equity markets, credit markets, and idiosyncratic, company-specific developments. Investment ideas are typically fundamental rather than quantitative and are generally realized around developments affecting a specific company rather than the general market.

The underlying sub-strategies may include activist, credit arbitrage, distressed/restructuring, merger arbitrage, private issue/Regulation D, or special situations.

6.2 Relative Value Strategies

Relative Value ("RV") strategies may invest across equity, fixed income, derivative, or other security types in order to realize an identified valuation discrepancy between securities. Managers' investment ideas may use fundamental and/or quantitative techniques. Fixed income RV strategies are typically quantitative and identify attractive opportunities based on value discrepancies or risk-adjusted spreads between instruments. RV may invest in corporate transactions based on the realization of a pricing discrepancy between related securities, but as opposed to ED, these investments are not based on the outcome of a corporate transaction.

The underlying sub-strategies may include fixed income—convertible bond arbitrage, fixed income—sovereign, statistical arbitrage, option volatility arbitrage, or yield alternatives.

6.3 Hedged Equity ~~Hedge~~ Strategies

Hedged Equity ~~Hedge ("EH~~("HE") strategies maintain long and short[16] positions primarily in equity and equity derivative securities. A wide variety of investment

[16]"Long" positions benefit from asset price increases while "short" positions benefit from asset price decreases.

processes can be employed to arrive at an investment decision, including use of both quantitative and fundamental techniques. The range of processes may include a multi-portfolio manager platform or single portfolio manager structure, a broadly diversified approach or narrow sector or thematic focus, net equity exposures from 100% short to 100% long, use of zero to high levels of leverage, short-term to multi-year holding periods, regional to global geographic market focus, growth to value styles, and small to large market capitalization focus.

The underlying sub-strategies may include equity market neutral, fundamental growth, fundamental value, quantitative directions, sector specific sub-strategies, or short bias.

6.4 Macro (~~Directional/~~Tactical) Strategies

Macro strategies may invest in equity, fixed income, currency, and/or commodity markets in order to benefit from ideas on economic variables and their impact on market movements, or the market movements themselves. Managers employ a variety of techniques including these: discretionary and systematic analysis, top-down and bottom-up ideas, quantitative and fundamental approaches, and long-term and short-term holding periods. Macro strategies are distinct from RV strategies in that the primary investment ideas are based on predicting future market movements~~,~~ rather than realizing valuation discrepancies between securities. In a similar way, while both Macro and ~~Equity Hedge~~Hedged equity strategies may hold equities, Macro equity positions are based on investment ideas that predict market movements and their effect on security prices based on macroeconomic variables, as opposed to EH, where company fundamentals are more important for development of investment ideas.

The underlying sub-strategies may include active trading, commodity (including its subsectors of agriculture, energy, and metals), discretionary currency, systematic currency, discretionary thematic, or systematic diversified.

6.5 Hedged Credit Strategies

Hedged Credit strategies may include investment in all credit securities as well as equities, credit derivatives, sovereign bonds, commodities, currencies, or other hybrid securities. Investment ideas are based on valuation discrepancies between credit instruments, or between credit securities and other security types. Hedged Credit is distinguished from the fixed income RV strategies in that Hedged Credit includes a significant component of investment ideas based on evaluation of credit quality of underlying instruments, rather than based on sovereign debt or interest rate exposures. Also, relative to fixed income RV strategies, Hedged Credit generally has more net exposure in credit markets, is less hedged, and is less leveraged.

The underlying sub-strategies may include corporate, emerging market sovereign, distressed, mezzanine debt, structured credit—residential mortgages, structured credit—commercial mortgages, other asset-backed, bank debt, direct lending, and capital structure arbitrage.

6.6 Multi-Strategy

Multi-Strategy managers invest across some or all of the five main strategy categories and may make tactical shifts among strategies at any given time. Multi-Strategy managers are not expected to have a dominant~~,~~ consistent weighting to any one strategy and instead are expected to have significant investment in more than one strategy category.

SECTION II – PROGRAM POLICIES

Policies for the Program are designed to allow access to returns available in flexible investment strategies that target returns from sources other than equity markets, as equity market risk is the most significant risk in LACERA's Total Fund, while controlling for risks that may lead to large losses. In the Program, controlling risk, limiting downside losses, and dampening overall volatility by diversifying the Total Fund away from general market risks are as important as seeking returns. LACERA adheres to prudent risk management practices by establishing guidelines that mitigate the main sources of risk in the Hedge Funds Program.

1. Risk Management

Hedge fund strategies generally entail a number of identifiable risks that are distinct from or heightened compared to traditional public market strategies. These include both investment-related and operational risks. It is LACERA's policy that the key risks particular to a hedge fund investment strategy be identified and understood. The ~~HFoF managers/HFAs aid~~HFA(s) aids LACERA in identifying, understanding, and monitoring risks in their portfolios and aggregated risks across the ~~program~~Program, including ~~in the other HFoF manager's portfolio~~all fund of funds and ~~LACERA's~~ direct ~~portfolio.~~ portfolios.

The types of risks are summarized in the following five main areas: illiquidity, transparency, leverage, quantitative risk, and operational risk. LACERA's methods for mitigating these risks are supplied below. ~~To~~Staff shall manage risk by applying these risk management practices to the entire Program.

As it relates to transparency risk, to the extent that a hedge fund's risks are opaque and cannot be sufficiently understood or identified, LACERA will not undertake an investment. If risks increase to a level beyond what is allowable in this OPP, LACERA will seek to redeem or reduce investments to bring the Program into compliance.
~~The types of risks are summarized in the following five main areas: illiquidity, transparency, leverage, quantitative risk, and operational risk. LACERA's methods for mitigating these risks are supplied below. Staff shall manage risk by applying the Risk Management Policy to the entire Program.~~

INVESTMENT RISK	METHOD OF MITIGATION
1. Illiquidity – Illiquidity may originate from the form of the assets or securities held by the underlying hedge funds as well as terms of the investment vehicle that delay investors' receipt of cash proceeds from their investments, e.g., lock-up periods, redemption periods, notification periods, or gates.	LACERA generally funds only those hedge funds that ~~are expected to~~ invest primarily in liquid assets. Additionally, the majority of the Program asset value is in hedge funds that have a lock-up period of one year or less and, after expiration of the lock-up period, a majority of Program asset value is in funds that provide for full or partial redemption at least quarterly. Beyond the initial lock-up periods, a liquidity schedule is maintained such that the majority of Program asset value is liquid within one year. ~~While the Program in total complies with this policy, it is recognized that the opportunistic credit portfolio generally invests in less liquid investments than the diversified portfolios and may include individual funds that invest primarily in less liquid assets.~~
2. Transparency – Many hedge funds may not fully disclose current position-level holdings.	LACERA requires ongoing disclosure of either position-level data or risk-exposure-level data from the hedge funds. Position-level data includes all of a fund's security holdings and their amounts. Examples of risk-exposure-level data include net and gross equity exposure, sector level net equity exposure, and net fixed income allocation by sector and credit quality category. Additionally, frequent communication with the hedge funds is undertaken by Staff ~~or~~and the HFA to understand the largest positions in the fund.
3. Leverage – The underlying hedge funds may use leverage, which enables them to gain financial exposure greater than invested capital.	LACERA does not permit excessive use of leverage in the Program. Appropriate leverage levels are dependent on the type of strategies used, the degree to which positions have offsetting risks, and the volatility of the assets held in the fund. The leverage ratio at the strategy level is not permitted to exceed 4.0x for hedged credit, event driven and hedged equity ~~hedge~~, 5.0x for multi-strategy, 8.0x for relative value, and 20.0x for macro and other tactical trading strategies. Portfolio-level leverage is monitored to manage the overall risk level of the Program. Only leverage derived from hedge fund managers' positions is permitted and no additional leverage will be added at the portfolio level.

4. <u>Quantitative Risk</u> – Hedge funds are exposed to a number of quantifiable market risks (e.g., beta and volatility levels).	LACERA's HFAs measure quantitative risks in the Hedge Funds Program through the use of their risk measurement system(s). Risk is evaluated at both the manager level and portfolio level to comply with this policy. The system(s) are used to identify unintentional risks in the portfolio which can be reduced through diversification and to identify portfolio changes which would reduce undesired risk levels while maintaining Program objectives. Other risk analyses used include scenario analysis to determine how the portfolio might behave in certain unfavorable market environments and value-at-risk analysis to identify the potential for losses in severe downside cases.
5. <u>Operational Risk</u> – Hedge fund investments are made through separate legal structures such as limited partnerships. Therefore, additional operational risk can arise when assets leave LACERA's custody.	LACERA invests only in hedge funds where an operational due diligence review determines that the funds' control and compliance environments are sufficient for investment. LACERA invests in funds that are administered by independent third parties, have assets that are held in custody by third parties, and are audited by reputable third parties. The valuation policies of the hedge funds are reviewed periodically to make sure that they are sufficiently strong.

2. Investment Exposure Parameters

At the portfolio level, measurable parameters are employed to mitigate some of the risks that might lead to portfolio losses.

For HFoF portfolios, risks are managed by investment guidelines in place for each portfolio. Though not included in this document, they are consistent with or more strict than the Program-level risk constraints in Section II, Subsection 1, Risk Management, of the OPP.

For LACERA's direct hedge fund portfolio, risk management will be governed by the risk parameters appearing below. Note that this portfolio may be out of the range of these parameters temporarily as LACERA builds its direct hedge fund portfolio to reach the ~~5~~4% target allocation by the fourth quarter of ~~2018.~~ 2019.

Additionally, beyond the time when the ~~5~~4% allocation is reached, fund notification period and redemption terms may prevent LACERA from immediately remediating an exposure outside of these parameters. LACERA will take prompt action to remediate any exposures outside the parameters.

LACERA Direct Hedge Fund Portfolio Risk Parameters

Risk Limits:

Estimated portfolio equity beta[17]	Not to exceed 0.20%
Target range of standard deviation	3-8%
Portfolio-level rate of Return at Severe Case Loss[18]	> -10%

Maximum Leverage by Investment Strategy Category:

Event Driven (excluding Credit)	4x
Relative Value	8x
Hedged Equity ~~Hedge~~	4x
Macro (Directional/Tactical)	20x
Hedged Credit	4x
Multi-Strategy	5x

Number of Investment Managers: The direct portfolio is expected to have between eight and ~~20~~twenty individual hedge funds.

Size of Investments: The minimum size of a hedge fund investment will be $5 million, while the maximum size of investment made will be 20% of LACERA's direct hedge fund market value. For the purposes of this policy, uninvested amounts that bring LACERA's total direct hedge fund investment up to the ~~5~~4% strategic policy allocation target shall be considered when determining the maximum investment.

Partnership/Investment Management Organization Limits: LACERA's share in a single hedge fund partnership or other entity structure will not exceed 35% of that organization's total commitments from all limited partners.

LACERA will limit maximum ~~exposure~~Program investments to any investment management organization such that the aggregate investment with that organization across multiple funds is not greater than 20% of LACERA's direct hedge fund portfolio market value. For the purposes of this policy, uninvested amounts that bring LACERA's total direct hedge fund investment up to the ~~5~~4% policy target shall be considered when determining the maximum investment.

[17] ~~As measured~~Based on forward looking estimates or realized performance measures relative to the MSCI All Country World Index.

[18] Return at Severe Case Loss is determined by applying a consistent measure of an unexpected negative return event for each fund (e.g., downside returns at a two standard deviation event), while applying some level of portfolio correlation by strategy (e.g., 0.4) which implies some level of diversification benefit across strategies.

Liquidity Limits: The portfolio may not invest so that more than 40% of the portfolio value is in funds that are subject to a remaining "lock-up" period greater than one year.

The portfolio may not invest so that more than 25% of the portfolio value is in funds that are subject to a remaining "lock-up" period greater than two years.

The portfolio may not invest so that more than 10% of portfolio value is in funds that are subject to a remaining "lock-up" period greater than three years.

The portfolio may not invest any capital in funds that require a "lock-up" period greater than five years.

Minimum capital invested as a percent of portfolio asset value in funds where full or partial liquidity is available within one quarter (excluding notification periods and after expiration of lock-up periods) is 40%.

Minimum capital invested as a percent of portfolio asset value where liquidity is available within one year (excluding notification periods and after expiration of lock-up periods) is 65%.

Side Pocket Investments: The portfolio is prohibited from investing in funds that make illiquid, "side pocket,[19]" or "designated" investments. Exceptions are allowable in the following cases:

- When the hedge fund offers investors the ability to opt-out of side pocket investments, in which case LACERA will make such election.
- When the hedge fund documents are silent about the ability to invest in side pocket investments, but LACERA and the HFA reasonably expect that the hedge fund manager will not make side pocket investments.
- When the hedge fund documents allow the ability to invest in side pocket investments, but LACERA and the HFA reasonably expect that the hedge fund manager will not make side pocket investments.

~~3.~~

3. Prohibited Investments

Hostile Takeovers: LACERA avoids investment strategies that primarily involve hostile takeovers, defined as acquisitions opposed by the board of directors of the target company.

[19] Side pocket investments in a hedge fund are usually less liquid than the remainder of the fund and are therefore accounted for differently. Generally, unlike the remainder of the fund, interests in these investments are allocated to investors at the time they are made and not to any future investors. Even if redeeming out of a fund, an investor may not be able to redeem out of its side pocket investments until those investments are realized.

LACERA Hedge Funds Privatization Policy: LACERA avoids investing in hedge funds that are dependent on privatization strategies. -LACERA does not aim to promote privatization of public jobs through its Hedge Funds Program.

When performing due diligence prior to making the initial investment in a fund for the direct hedge fund portfolio, Staff and/or the HFA, as applicable, will use reasonable efforts to ascertain the following:

- Whether the fund's main investment strategy includes the privatization of jobs held by LACERA members, and
- Whether other funds operated by the investment management organization, if any, have invested in companies dependent upon privatization of jobs held by LACERA members.

4. Investment Vehicle Guidelines

Limitation of Liability:

LACERA anticipates that its investments in this Program will take place through pooled investment vehicles that limit its liability to the amount of its capital commitment to the fund. -LACERA, or its external legal advisors, will review fund documents before investment to determine that they are governed by the laws of a jurisdiction that recognizes and preserves investors' limited liability.

Taxability: LACERA, or its external legal advisors, will also review fund documents and consider the jurisdictions in which the funds are formed to confirm that they are "tax neutral."

5. Legal

Investments are made, managed, and redeemed in compliance with applicable federal, state, and local country-specific laws. -Qualified legal counsel selected by the Legal Office, or Legal Office staff, reviews or negotiates fund documents, side letters, and other legal documents associated with investments.

6. Derivatives

Given that hedge fund managers may have discretion to use short selling, leverage, and derivatives, LACERA's Derivatives Policy will not apply to Hedge Funds Program investments.

7. Fees

LACERA requires fee transparency from its investments in hedge funds, specifying the amount of management fees and accrued performance fees which affect LACERA's net performance. -LACERA is complying with new California legislation that requires disclosure of hedge fund fees.

SECTION III – PROGRAM PROCEDURES

Investing in hedge funds requires unique investment procedures. This section defines and explains the methodologies used when investing in this Program.

1. Capital Planning

~~In the 2018~~

For each calendar year, a Hedge Funds Annual Investment Plan ("HFAIP"), ~~Staff~~ will ~~recommend a specific~~establish a pace of investing that will result in an allocation that will fall within the target allocation range. Over the next few years, the focus of the HFAIP will be on new allocations to managers to fully fund the direct hedge fund portfolio. LACERA currently invests in diversified fund of funds and direct hedge funds. ~~LACERA currently invests in diversified fund of funds and credit fund of funds. LACERA will invest in the direct hedge fund portfolio after the approval of this policy document and the HFAIP.~~

~~After the full 5% strategic allocation to Hedge Funds is reached (expected by Q4 2018), allocations will be moved from diversified hedge fund of funds to direct hedge funds, so that each diversified hedge fund of funds portfolio will be reduced to an approximate net asset value of $250 million. $250 million is the initial amount allocated to each HFoF manager.~~

~~Once each diversified HFoF portfolio is brought down to approximately $250 million, LACERA may re-evaluate the role of its HFoF managers in its Program. At that time, LACERA may consider alternative investment structures that eliminate one or both HFoF managers and consider the retention of an HFA that acts in a purely advisory capacity.~~

2. Sourcing Investments

Currently the HFoF managers source investments through the resources of their manager research staffs. For the direct portfolio, ~~Staff~~LACERA and the HFA ~~(at Staff's request)~~ will source potential investments and identify those that meet the Program's selection criteria and performance goals. All investment opportunities that meet the established criteria and goals will be considered. ~~In the initial phase of filling the direct hedge fund allocation, LACERA may consider the use of a targeted Request for Information process to assist in selecting funds.~~

LACERA will avoid undue fund or manager overlap or concentration between LACERA's direct hedge fund portfolio and the underlying HFoF portfolio. If LACERA holds or is preparing to hold a fund or manager in its direct hedge fund portfolio, LACERA may prohibit the HFoF managers from holding or adding that fund or manager, or may require the redemption or transfer of a fund or manager already held in a HFoF portfolio.

Methods of sourcing prospective investments include, but are not limited to, the following:

- Meeting investment managers in LACERA's ~~or~~, the HFA's, or investment manager's offices,

- Accessing the ~~HFA's~~ market intelligence or databases from the HFA(s) or other sources,

- Referencing funds already approved for investment by an HFA or HFoF manager,
- ~~Traveling to and holding meetings at the offices of investment managers~~

- Meeting with placement agents who represent investment managers,

- Attending investment conferences to meet investment managers,

- Cold-calling potential investment managers, and
- ~~Accessing proprietary databases to identify potential investment managers~~

- Reading industry publications to keep abreast of people and fund news.

3. Conducting Due Diligence

By conducting due diligence, ~~Staff~~LACERA and the HFA/HFoF manager pursue favorable investments and reject those that do not meet the Program's criteria. Major factors to be considered ~~by either Staff and/or HFA,~~ include, but are not limited to, the following:

- Experience and cohesiveness of the investment manager or principals involved,

- Depth of resources at the investment management organization, including personnel and technology,

- Soundness of the investment manager's strategy,
~~Suitability~~
- Attractiveness of the strategy in the current market environment and the manager's ability to capitalize on it,
- Assessment of the expected risk/return profile of the strategy, including volatility and expected diversification benefits,
~~Appropriateness~~
- Fit and appropriateness of the investment for inclusion in LACERA' s portfolio,

- Manager's knowledge of the securities or instruments used in the investment process,

- Appropriateness of the investment manager's risk management practices,

- Transparency of manager with respect to the strategy,

- Financial health and sustainability of the investment management firm,
- Attribution of the investment manager's track record to skill rather than market factors,
- Compliance with LACERA's guidelines,
- Compliance with all national, state, and local financial, regulatory, and legal requirements and evaluation of any audit reports,
- Observations and findings of a recent full operational due diligence review by the HFA or an external provider which ~~includes~~investigates the manager's operating, control, and compliance environments,
- Consistently positive references and background checks on the investment management firm and key personnel,
- Appropriate level of the investment manager's Environmental, Social, and Governance risk analysis in place~~.~~, and
- Approach to diversity and inclusion at the investment manager organization.

4. Addressing Conflicts of Interest

~~**Staff**~~

LACERA and the HFA will not recommend/make any investment until all identified real and potential conflicts of interest have been assessed and mitigated to the extent deemed appropriate.

5. Structuring and Negotiating Key Terms, Provisions, and Fees

Staff will negotiate terms and provisions and structure fees so as to provide maximum investor protection and value.
~~In order to construct a direct hedge fund portfolio that has lower fees than the "standard" 2% management fee and 20% performance fee,~~
LACERA will consider opportunities to lower fees that some managers may offer for larger allocations, or for extended lock-up terms. Staff may recommend the Board approve exceptions to the policies in this document (e.g. limitations on amount of portfolio value which is subject to remaining lockup periods of greater than two years) for certain hedge funds in order to receive lower fees. LACERA may also consider fee arrangements with a lower management fee, but potentially higher performance fee. LACERA will take into consideration the fee breaks available through its HFA relationship.

6. Approving Investments in the Direct Portfolio

Consistent with LACERA's current governance model, all direct hedge fund investments will be recommended by ~~Staff~~staff and the HFA and will be subject to Board approval.

Any ~~Staff~~staff recommendation of a direct hedge fund investment for Board approval will be accompanied by an opinion memo from an HFA. This memo will address investment merit, risks, fit with LACERA's portfolio, objectives, and constraints, and an assessment of the fund's operating, control, and compliance environment.

~~7.~~

7. Rebalancing and Redeeming Funds in the Direct Portfolio

Investments in a direct hedge fund portfolio require the flexibility to rebalance the portfolio and terminate managers in a timely manner, within the terms of the notification period and fund redemption schedule for each fund.

In order to rebalance the portfolio to take advantage of changes in market opportunities or reflect evolving views on a manager, LACERA will need to add to or partially redeem from certain funds from time to time. When funds are recommended for approval by the Board, ~~Staff~~staff will propose an initial investment amount and maximum allocation. LACERA ~~Staff~~staff may add capital to or reduce amounts invested with already approved managers as long as the value of the new investment amount remains below the maximum allocation amount. A summary of fund additions and redemptions will be reported to the Board periodically~~.~~ through regular quarterly reporting and the monthly CIO Letter.

LACERA may also need to take rapid action to terminate an investment manager for various reasons that include unexplained poor performance, staff turnover, change in fund strategy, evidence of unethical manager behavior, or the existence of more attractive opportunities elsewhere. Staff may terminate funds by requesting a full redemption at the next available redemption period and will promptly report terminations to the Board.

8. Monitoring and Reporting Portfolio Performance

Use of Third Party Administrators in Performance Reporting: In order to provide additional monitoring, independent of reporting provided by HFoF managers, and to provide specialized accounting services for its direct hedge fund portfolio, LACERA requires the use of third party Administrators. Administrators are responsible for accounting for all investor-level activity in a hedge fund portfolio, reporting official independent portfolio valuations and performance on a monthly basis, and reporting interim monthly valuations as required by Staff or the HFoF manager. The selection of Administrators varies by portfolio.

Grosvenor Capital Management ("GCM") is a HFoF manager that uses partnership structures to hold underlying funds for its three portfolios and acts as general partner for its partnerships. As general partner, GCM is responsible for selecting and overseeing the Administrator for these partnerships, and that Administrator delivers valuation and performance reports for each partnership directly to LACERA and its Custodian.

For the Goldman Sachs Asset Management ("GSAM") HFoF portfolio, where LACERA holds the fund interests directly, the fund of funds manager acts under a discretionary Investment Management Agreement. For the GSAM portfolio, LACERA has procured International Fund Services, LLC ("IFS"), a wholly owned division of State Street, LACERA's Custodian, to act as a portfolio-level Administrator. ~~Staff intends for IFS to act~~LACERA may also substitute the Custodian as Administrator for the direct ~~portfolio~~and GSAM portfolios or otherwise evaluate alternative solutions.

Reporting to LACERA's Staff: The Administrators track capital flows, measure returns, and provide monthly portfolio performance reports to ~~Staff.~~ LACERA. Additionally, the HFoF managers provide monthly and quarterly reporting with analyses regarding the portfolios they manage for LACERA. Individual fund managers provide various forms of monthly, quarterly, or annual reports regarding fund positioning, performance, and outlook.

Calculation of Composite Returns: LACERA's Custodian, State Street, receives portfolio values from the Administrators and calculates multiple portfolio composite returns and the Hedge Funds Program composite return ~~in the reporting process.~~. LACERA's hedge fund performance is consolidated into the Total Fund performance on a one-month lagged basis. This approach allows the Administrator time to capture the closing period cycle for the underlying hedge funds, which have a valuation cycle that often exceeds the global custodian's monthly cutoff for unlagged performance. LACERA may remove the lag in the future if it can obtain sufficient performance data for the hedge fund program within its normally monthly closing cycle.

Reporting to the Board: Staff shall issue quarterly portfolio performance reports to the Board. In addition, ~~Staff~~staff and at least one of the HFAs shall report to the Board at least annually on the performance and status of ~~investments held in the portfolio.~~ the Program. Reports shall include, but not be limited to, such items as the following:

- Risk and return across the Program and its portfolios,
- Summary of investment portfolio performance and its relation to overall market performance,
    - Program impact on the Sharpe ratio of the Total Fund,
- The general investment environment,
- Allocations across different strategies of hedge funds,
- Capital activity such as new commitments, contributions, redemptions, and terminations made since the last report,
- Summary of new investments and redemptions by strategy, and

  Compliance with applicable LACERA policies/risk limitations.

Monitoring Adherence to Strategy: Staff shall monitor the type, amount, and allocation of investments to ensure that the strategy set forth in this document is adhered to. LACERA expects staff and ~~the HFA~~and any HFoF managers to strictly adhere to the ranges set forth in this document, to any other applicable portfolio guidelines, as well as to the investment guidelines as set forth in the HFAIP or as agreed upon from time to time by LACERA and ~~the HFA.~~ any HFoF managers.

9. Implementation Using Separate Accounts or "Funds of One"

LACERA will explore the use of structures which include directly managed separate accounts or "funds of one[20]" that allow LACERA greater operational control over its direct hedge fund investments. ~~-~~The advantages of these structures are that they allow for greater control over assets, lower operational costs, an enhanced negotiating position for lower management and performance fees, full transparency, and an enhanced comfort to take on emerging managers.~~-~~ The disadvantages are greater operational complexity for LACERA and an unwillingness of some fund managers to add to their own operational risk and complexity with these structures. ~~-~~While these structures provide some overall improvements to LACERA, a fund manager's unwillingness to adopt these structures will be considered but not generally used to exclude funds from recommendation.

10. Planning for a Hedge Fund Emerging Manager Program

In 2019, LACERA will also explore strategies through Committee and Board discussions for constructing an emerging manager hedge fund portfolio. Such strategies may include converting all or a portion of an existing Diversified HFoF portfolio mandate to an Emerging Manager HFoF portfolio mandate. This portfolio would follow policies and objectives for emerging manager portfolios that already exist in LACERA's other asset categories.

SECTION IV – SUMMARY OF ROLES AND RESPONSIBILITIES

The roles of the Board, ~~Staff~~staff, HFA, Hedge Fund of Funds Manager, Administrator, Custodian, and the General Consultant are summarized below:

1. Board Responsibilities

- Review and approve the Hedge Funds Objectives, Policies, and Procedures~~-~~,
- Review and approve the HFAIP~~–~~,
- Review performance of the Program with the HFA and/or ~~Staff~~staff at least annually
- Review and approve direct allocations to externally managed funds and fund of funds mandates~~-~~, and

[20]A "Fund of One" structure is a customized investment vehicle such as a Limited Partnership for which LACERA would be the sole limited partner.

- Refer hedge fund investment opportunities to ~~Staff~~staff for evaluation, either directly or with the assistance of the HFA~~–~~.

2. Staff Responsibilities

- Develop, evaluate, review, and make recommendations to the Board on the Hedge Funds Objectives, Policies, and Procedures~~–~~,
- Review the HFAIP at least annually, recommending changes to the Board as appropriate~~–~~,
- Monitor and report on the activities of the HFAs to the Board~~–~~,
- Conduct searches for HFAs as authorized by the Board~~-~~,
- Source, screen, evaluate, and recommend investments to the Board in consultation with the HFAs,
- Perform investment due diligence on prospective investment managers and investment opportunities that potentially fit the objectives and constraints of the Program,
- Review with an HFA the operational due diligence findings for managers recommended by ~~Staff~~staff,
- Monitor the investment managers in the direct portfolio on an ongoing basis, and consider their replacement with other more attractive investment opportunities~~-~~,
- Ensure that adequate measurement systems are implemented to monitor the performance and fees of the Program~~-~~,
- Meet with the HFA and the Board at least annually to review Program performance, ~~asset~~ allocation to the various hedge fund portfolios and other parameters, and other issues that arise~~–~~,
- Assure that LACERA has appropriate legal counsel resources to work with ~~Staff~~staff to review terms and conditions on all proposed investment vehicles~~–~~,
- Document due diligence procedures undertaken for recommended investments, and
- Maintain internal processes for administering LACERA's role in financial operations of direct and HFoF portfolios.

3. HFA~~/~~ and Hedge Fund of ~~Fund~~Funds Manager Responsibilities

- Act as fiduciary throughout all phases of the investment process, as overseen by LACERA~~. Specific processes covered~~ that may include investment sourcing, consideration, evaluation, recommendation, negotiation, reporting, and monitoring,
- Assist LACERA Board and Staff in identifying potential investment opportunities, conducting due diligence, and monitoring investments,
- For the direct portfolio, provide a written memo and appear at Board meetings in reference to potential fund investments recommended by Staff,
- For the direct portfolio, provide an operational due diligence report addressing the operating, control and compliance environment related to funds and investment management organizations recommended by ~~Staff~~staff,
- Make investment selections within approved fund of funds mandates,
- Serve the interest of the Board in support of its fiduciary obligation to LACERA,
- Carry out strategic or portfolio-based initiatives as directed by the Board~~–~~,
- Review Draft HFAIP~~–~~,
- Provide portfolio performance reporting and evaluation for discretionary portfolios,
- Meet with the Board and ~~Staff~~staff at least annually to review performance of the hedge fund portfolio(s) and the Program,
- Provide the Board and ~~Staff~~staff with ongoing educational presentations and/or materials covering market conditions and developments as requested,
- Proactively disclose any perceived or actual conflicts of interest which become apparent to the HFA, and
- With respect to the Grosvenor HFoF: act as general partner in HFoF partnership structures and oversee third party administration, perform cash management for fund of funds, and properly oversee all partnership functions.

4. Administrator Responsibilities

- Maintain accounting records and provide timely official portfolio positions to the Custodian, LACERA, and, if applicable, the HFoF manager,
- Calculate monthly performance of each portfolio and provide this data to the Custodian and LACERA,

- Provide interim valuation and performance estimates of each portfolio to LACERA and, if applicable, the HFoF manager~~.~~,

5. Custodian Responsibilities

- Calculate performance of multi-portfolio hedge fund composites and of the Program over various time periods, and

- Provide all Hedge Funds Program performance figures that are consolidated into LACERA's Total Fund performance.

6. General Consultant Responsibilities

- Review the OPP and make any recommendations,

- Review the HFAIP annually~~.~~,

- Review Program-level recommendations for compliance with LACERA policy, and

- Report to the Board on any Program issues, as appropriate.

SUMMARY STATEMENT

~~This document outlines the basic objectives, policies, and procedures of LACERA's Hedge Fund Program as its structure transitions from one invested entirely in fund of funds to one which also includes a directly invested hedge fund portfolio. Subject to future modifications by the Board, this document establishes the parameters for the Program as LACERA increases its investment in hedge funds to reach its 5% strategic allocation (which is expected by Q4 2018).~~

This document establishes the framework and practices by which the Hedge Fund Program is to be implemented. These objectives, policies, and procedures will be updated annually to meet the evolving needs of the Hedge Fund Program.

ATTACHMENT 2

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

HEDGE FUNDS

Objectives, Policies, and Procedures

September 12, 2018

HEDGE FUNDS OBJECTIVES, POLICIES, and PROCEDURES

TABLE OF CONTENTS

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION
HEDGE FUNDS OBJECTIVES, POLICIES, AND PROCEDURES

DOCUMENT PURPOSE

The Hedge Funds Objectives, Policies, and Procedures ("OPP") document sets forth in further detail certain elements of LACERA's Diversified Hedge Funds Investment Program (the "Program," "Hedge Funds," or "Hedge Funds Program") which are broadly outlined in LACERA's Investment Policy Statement ("IPS"). The OPP defines the Program's objectives and high level parameters, stipulates the detailed policies that govern the Program, establishes risk management practices, spells out the procedures to be followed, and delineates the responsibilities of the Board of Investments (the "Board"), LACERA staff, the Hedge Funds Advisor(s) ("HFA"), the hedge funds portfolio administrator(s) ("Administrator"), LACERA's custodian (Custodian"), and LACERA's general consultant ("General Consultant"). In essence, the OPP provides the blueprint that guides the structure and implementation of the Program and its underlying portfolios.

SECTION I – PROGRAM OBJECTIVES

1. Introduction

The Board has determined that, over the long term, inclusion of diversified hedge fund investments will enhance the risk/return characteristics of the Total Fund. As established in the Investment Policy Statement "IPS", the Hedge Funds Program has an objective to reduce the volatility of the Fund without materially decreasing Fund returns. Primarily, the Hedge Funds Program enhances the diversification of the Total Fund portfolio. This objective is achieved through investing in targeted strategies that have low to moderate correlation with public global equity returns, and have historically exhibited moderate return volatility. Hedge funds have historically had greater volatility than fixed income markets while having less than half the volatility of public global equity markets.

2. Role of Hedge Funds in the Total Fund

The IPS states that the Program objective–to reduce Fund volatility without materially decreasing Fund returns–should be measured and evaluated by the Sharpe ratio[1]. The Program is expected to improve the Sharpe ratio of the Total Fund. Even modest improvements in the Sharpe ratio benefit the Fund's ability to compound returns over the long run.

Investment decisions regarding the Program's primary objective of reducing volatility while maintaining returns are guided by the following separate objectives: (i) generating returns that exceed a target annualized return of 250 basis points[2] greater than an index of 3-month United States Treasury bills ("T-bills"), (ii) achieving realized volatility of 3-8% as measured by the annualized standard deviation of monthly returns, and (iii) maintaining a Program beta of 0.25 or lower to public global equity markets as measured by the Morgan Stanley Capital International ("MSCI") All Country World Index.

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[1]Sharpe ratio is a measure of the excess return of the program over cash divided by program volatility as measured by standard deviation of returns.
[2] Subject to Board approval. Benchmark review scheduled for September 12, 2018 BOI Meeting.

3. Hedge Funds Asset Allocation

In May 2018, the Board established a long-term target allocation to diversified Hedge Funds of 4%. This allocation is part of a newly-created Risk Reduction and Mitigation asset category that also includes investment grade fixed income and cash. Previously the asset allocation target for all hedge funds, including credit hedge funds of funds was 5% of the Total Fund asset value.

Additionally, the new May 2018 allocation policy re-categorized credit hedge fund of funds strategies, previously categorized under the Hedge Funds Program, to a new sub-category called Illiquid Credit within a new asset category named Credit. The credit hedge fund of funds portfolios comprised 0.7% of the Total Fund as of June 30, 2018. The new policy allocation to Illiquid Credit is 3%. The allocation to Illiquid Credit includes other investments apart from Credit hedge fund of funds and will be managed by the Credit team and will continue to be overseen by the Credit and Risk Mitigation Committee (formerly Fixed Income/ Hedge Funds/ Commodities Committee).

Any reference to the Diversified Hedge Funds Investments (the "Program," "Hedge Funds," or "Hedge Funds Program") herein will exclude credit hedge fund of funds investments.

As of June 30, 2018, the actual Hedge Funds Program allocation is 2.2% of the Total Fund[3]. As the actual allocation is currently below the long-term target allocation, which is planned to be reached in Q4 2019, an interim target allocation for Diversified Hedge Fund Investments is being recommended at the September 2018 BOI meeting to be 3.0% at the beginning of 2Q19. The Diversified Hedge Funds policy allocation is planned to change in the following quarters as shown in **Table 1** below.

Table 1
Target Hedge Funds Allocation by Quarter

Calendar Quarter	Target Diversified Hedge Funds Allocation
Current	2.2%
Q2 2019	3.0%
Q4 2019	4.0%

The Total Fund asset allocation policy in the IPS limits the actual Hedge Funds allocation to a range around the target allocation whereby the minimum allocation is the lower of 0% or 4% less than target, and the maximum allocation is 2% greater than the target. Thus, at the proposed 3% target allocation, the hedge funds allocation range is 0% to 5%. At the final 4% target allocation, the allocation range will be 0% to 6%.

[3]$1.23 billion asset value of Hedge Funds and $56.0 billion Total Fund asset value.

4. Program Objectives and Parameters

4.1 Program Benchmark Return

A recommendation to the Board of Investments is being made at the September 2018 BOI meeting which, consistent with the General Consultant's capital market assumptions, would make the primary Diversified Hedge Fund Program benchmark an annualized return of 250 basis points greater than an index of 3-month United States Treasury bills ("T-bills")[4]. The benchmark is used to evaluate the performance of the Program over three to seven years. When measuring realized returns against this objective, the returns are net of all fees charged by underlying hedge funds and any fund of funds managers.

Program returns are also measured against a universe of similar hedge fund strategies, as provided by a reliable third party source such as Hedge Fund Research, Inc. ("HFR"). By measuring performance over three to seven years, the Program's performance relative to a fund universe can be considered. **Table 2** identifies benchmarks for each portfolio type within the Program. A description for each portfolio follows in Section 5 of this HFAIP.

Table 2
Fund Benchmarks by Type

Portfolio Type	Primary Benchmark	Secondary Benchmark
Diversified Hedge Fund of Funds	3 month T-bills plus 250 bps annualized[5]	HFRX Global Index[6]
Direct Hedge Funds		
Total Diversified Hedge Funds Portfolio		

[4] This benchmark has been 500 basis points greater than an index of 3-month United States Treasury bills ("T-bills") since the inception of the program.
[5] Subject to BOI approval.
[6] The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies, including but not limited to convertible arbitrage, distressed securities, hedged equity, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset weighted. *Source: Hedge Fund Research, Inc.*

4.2 Program Parameters

The Diversified Hedge Funds Program is expected to have volatility greater than that of fixed income markets but less than that of public equity markets, generally at a level of less than half of public equity market volatility. Realized volatility, as measured by standard deviation of returns, is expected to range from 3-8% over three-year rolling time periods. The program is expected to have low to moderate correlation with public global equities and will be managed by maintaining a portfolio equity beta[7] of 0.25 or lower.

5. Investment Structure

The Fund currently invests in two diversified portfolio types in the Program (hedge fund of funds and direct hedge funds).

The Fund currently deploys capital to two Hedge Fund of Fund ("HFoF") managers - Grosvenor Capital Management ("GCM") and Goldman Sachs Asset Management ("GSAM"). GCM and GSAM each run a diversified HFoF portfolio for the Program. GCM also runs two credit HFoF portfolios which are categorized under the Illiquid Credit sub-category in the Credit asset category.

As the Program implementation moves forward, direct hedge fund investments are used for the advantages they provide to the Fund, namely that they are not subject to the additional layer of fees paid to fund of funds managers, they facilitate direct relationships with hedge fund managers, and they allow the Fund to have greater control over its Program.

In addition to their existing fiduciary role in investing the fund of funds portfolios, the HFoF managers have also agreed contractually to serve as HFAs, acting as a fiduciary, to support LACERA investing directly in hedge funds. The roles and responsibilities of the HFA are further described in the OPP. LACERA issued a Request for Proposal for a Consultant(s) in the Hedge Funds, Credit and Real Assets categories. When and if LACERA selects a separate Hedge Fund Consultant, the Consultant will act as an HFA.

Hedge Fund Program Portfolio Types

1. Diversified Hedge Fund of Funds: HFoF portfolio managed by an external HFoF manager who invests across hedge fund strategies. HFoF managers have discretion to construct portfolios consistent with the Hedge Fund section of LACERA's Investment Policy Statement and any individual portfolio guidelines.

[7] Portfolio equity beta is a measurement of a portfolio's volatility relative to equity market returns. A portfolio with a beta of 1.0 has the same volatility as the equity market. Mathematically, historical beta can be viewed as the slope of the regression line of portfolio returns against market returns. The Morgan Stanley Capital International All Country World Index is used as the global equity market reference against which to measure equity beta realized by the Program.

Each HFoF manager identifies, selects, and monitors these investment strategies as part of a diversified portfolio.[8]

2. Direct Hedge Funds: Diversified portfolio of hedge funds invested across hedge fund strategies, with LACERA selecting the managers and strategies. LACERA retains discretion to construct and maintain a portfolio consistent with the Program policies including the OPP and this HFAIP. As additional resources, the HFAs provide independent due diligence and technical assistance to LACERA in support of areas including market research, investment due diligence, operational due diligence, portfolio construction, and risk aggregation.

Table 3 shows the current allocation to the portfolio types among LACERA's Hedge Funds Program and defines the allowable allocation range for the Program.

Table 3
LACERA Hedge Funds Program
Current and Allowable Allocation By Portfolio Type

Portfolio Type	Allowable Allocation Range
Diversified Hedge Fund of Funds[9]	0-90%
Direct Hedge Funds	0-100%
Total Program	

6. Investment Strategy Categories

LACERA's achievement of its Hedge Funds Program objectives requires an ability to adjust portfolio allocations across various hedge fund strategy categories since each may respond differently to prevailing market environments. The Program-level investment category constraints (shown in **Table 4)** limit strategy category exposures in order to promote diversification across strategy categories while also being flexible enough to allow for tactical shifts in and out of strategies based on their relative attractiveness and the market environment.

The constraints for each of the six investment strategy categories (defined and discussed below) are measured on a look-through basis.[10] Individual fund of fund

[8]The Fund's contractual relationship with Goldman Sachs Asset Management regarding the diversified HFoF portfolio is through a discretionary investment management agreement rather than a fund agreement in part because those underlying funds are held directly in the Fund's name.

[9]When invested to reach the 4% strategic asset allocation Total Fund target, 22% of the Hedge Funds Program would be approximately $500 million (at a $56 billion Total Fund valuation). LACERA's initial allocation to its two HFoF managers was $250 million each. This minimum level of investment is necessary for LACERA to continue to receive HFA services as part of its agreements with the HFoF managers. Approximately 22% of the Program is the longer term target for the diversified HFoFs after LACERA reaches its 4% strategic allocation target.

[10]Look-through basis for the Hedge Funds Program is defined as the total strategy category allocation based on the underlying portfolios in the Program, viewed independently of their portfolio structure.

portfolios have investment guidelines that are consistent with or more limiting than these Program-level constraints.

Definitions for the categories generally draw from the index definitions created by HFR. HFR's definitions of the first four categories in the table are objective and follow predetermined rules which place all eligible hedge funds in their Global Index into one of these four categories. However, solely using these four definitions can be limiting to broad portfolio construction, and LACERA has broadened the strategy categories to include Hedged Credit and Multi-Strategy. While the six categories are commonly used, they do not represent an exhaustive list that covers all possible hedge fund investments. The Program may invest in some funds that are not well-described by one of these strategy definitions if they otherwise meet broad objectives and constraints established for the Program.

Additionally, LACERA may consider investing in "hedge fund premia" or replication-type strategies that seek to obtain systematic exposures to investment themes used by hedge funds, but at a lower cost. These strategies are expected to fall within the six strategy categories identified below.

Table 4
Diversified Hedge Funds Investment Allocation
Constraints by Strategy Category

Strategy	Strategy Constraint	Target Allocation of Direct Portfolio
Event Driven (excluding Hedged Credit)	Maximum 40%	7.5%
Relative Value	Maximum 60%	15%
Hedged Equity	Maximum 40%	15%
Macro/Tactical Trading	Maximum 50%	15%
Hedged Credit	Maximum 60%	7.5%
Multi-Strategy	Maximum 60%	40%

The table includes the target allocation for the direct portfolio when it is fully invested by year end 2019.

LACERA recognizes the opportunistic nature of investing in these strategies and will allow latitude regarding the lower and upper limits of allocation constraints and targets. In the short term, as LACERA sequentially ramps up its allocations in the direct portfolio to reach the 4% Total Fund target allocation, some individual fund allocations may cause large changes in the strategy allocation weights in the direct portfolio. Thus, these strategy constraints might not be met during the ramp up phase.

6.1 Event Driven Strategies

Event Driven ("ED") strategies invest in securities of companies undergoing or expected to undergo corporate transactions, including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance, or other capital structure adjustments. Security types may include equities; senior, junior, or subordinated debt; and derivatives. ED investments may include exposure to equity markets, credit markets, and idiosyncratic, company-specific developments. Investment ideas are typically fundamental rather than quantitative and are generally realized around developments affecting a specific company rather than the general market.

The underlying sub-strategies may include activist, credit arbitrage, distressed/restructuring, merger arbitrage, private issue/Regulation D, or special situations.

6.2 Relative Value Strategies

Relative Value ("RV") strategies may invest across equity, fixed income, derivative, or other security types in order to realize an identified valuation discrepancy between securities. Managers' investment ideas may use fundamental and/or quantitative techniques. Fixed income RV strategies are typically quantitative and identify attractive opportunities based on value discrepancies or risk-adjusted spreads between instruments. RV may invest in corporate transactions based on the realization of a pricing discrepancy between related securities, but as opposed to ED, these investments are not based on the outcome of a corporate transaction.

The underlying sub-strategies may include fixed income—convertible bond arbitrage, fixed income—sovereign, statistical arbitrage, option volatility arbitrage, or yield alternatives.

6.3 Hedged Equity Strategies

Hedged Equity ("HE") strategies maintain long and short[11] positions primarily in equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including use of both quantitative and fundamental techniques. The range of processes may include a multi-portfolio manager platform or single portfolio manager structure, a broadly diversified approach or narrow sector or thematic focus, net equity exposures from 100% short to 100% long, use of zero to high levels of leverage, short-term to multi-year holding periods, regional to global geographic market focus, growth to value styles, and small to large market capitalization focus.

The underlying sub-strategies may include equity market neutral, fundamental growth, fundamental value, quantitative directions, sector specific sub-strategies, or short bias.

[11] "Long" positions benefit from asset price increases while "short" positions benefit from asset price decreases.

6.4 Macro (Tactical) Strategies

Macro strategies may invest in equity, fixed income, currency, and/or commodity markets in order to benefit from ideas on economic variables and their impact on market movements, or the market movements themselves. Managers employ a variety of techniques including these: discretionary and systematic analysis, top-down and bottom-up ideas, quantitative and fundamental approaches, and long-term and short-term holding periods. Macro strategies are distinct from RV strategies in that the primary investment ideas are based on predicting future market movements rather than realizing valuation discrepancies between securities. In a similar way, while both Macro and Hedged equity strategies may hold equities, Macro equity positions are based on investment ideas that predict market movements and their effect on security prices based on macroeconomic variables, as opposed to EH, where company fundamentals are more important for development of investment ideas.

The underlying sub-strategies may include active trading, commodity (including its subsectors of agriculture, energy, and metals), discretionary currency, systematic currency, discretionary thematic, or systematic diversified.

6.5 Hedged Credit Strategies

Hedged Credit strategies may include investment in all credit securities as well as equities, credit derivatives, sovereign bonds, commodities, currencies, or other hybrid securities. Investment ideas are based on valuation discrepancies between credit instruments, or between credit securities and other security types. Hedged Credit is distinguished from the fixed income RV strategies in that Hedged Credit includes a significant component of investment ideas based on evaluation of credit quality of underlying instruments, rather than based on sovereign debt or interest rate exposures. Also, relative to fixed income RV strategies, Hedged Credit generally has more net exposure in credit markets, is less hedged, and is less leveraged.

The underlying sub-strategies may include corporate, emerging market sovereign, distressed, mezzanine debt, structured credit—residential mortgages, structured credit—commercial mortgages, other asset-backed, bank debt, direct lending, and capital structure arbitrage.

6.6 Multi-Strategy

Multi-Strategy managers invest across some or all of the five main strategy categories and may make tactical shifts among strategies at any given time. Multi-Strategy managers are not expected to have a dominant consistent weighting to any one strategy and instead are expected to have significant investment in more than one strategy category.

SECTION II – PROGRAM POLICIES

Policies for the Program are designed to allow access to returns available in flexible investment strategies that target returns from sources other than equity markets, as equity market risk is the most significant risk in LACERA's Total Fund, while controlling for risks that may lead to large losses. In the Program, controlling risk, limiting downside losses, and dampening overall volatility by diversifying the Total Fund away from general market risks are as important as seeking returns. LACERA adheres to prudent risk management practices by establishing guidelines that mitigate the main sources of risk in the Hedge Funds Program.

1. Risk Management

Hedge fund strategies generally entail a number of identifiable risks that are distinct from or heightened compared to traditional public market strategies. These include both investment-related and operational risks. It is LACERA's policy that the key risks particular to a hedge fund investment strategy be identified and understood. The HFA(s) aids LACERA in identifying, understanding, and monitoring risks in their portfolios and aggregated risks across the Program, including all fund of funds and direct portfolios.

The types of risks are summarized in the following five main areas: illiquidity, transparency, leverage, quantitative risk, and operational risk. LACERA's methods for mitigating these risks are supplied below. Staff shall manage risk by applying these risk management practices to the entire Program.

As it relates to transparency risk, to the extent that a hedge fund's risks are opaque and cannot be sufficiently understood or identified, LACERA will not undertake an investment. If risks increase to a level beyond what is allowable in this OPP, LACERA will seek to redeem or reduce investments to bring the Program into compliance.

INVESTMENT RISK	METHOD OF MITIGATION
1. Illiquidity – Illiquidity may originate from the form of the assets or securities held by the underlying hedge funds as well as terms of the investment vehicle that delay investors' receipt of cash proceeds from their investments, e.g., lock-up periods, redemption periods, notification periods, or gates.	LACERA generally funds only those hedge funds that invest primarily in liquid assets. Additionally, the majority of the Program asset value is in hedge funds that have a lock-up period of one year or less and, after expiration of the lock-up period, a majority of Program asset value is in funds that provide for full or partial redemption at least quarterly. Beyond the initial lock-up periods, a liquidity schedule is maintained such that the majority of Program asset value is liquid within one year.

2. Transparency – Many hedge funds may not fully disclose current position-level holdings.	LACERA requires ongoing disclosure of either position-level data or risk-exposure-level data from the hedge funds. Position-level data includes all of a fund's security holdings and their amounts. Examples of risk-exposure level data include net and gross equity exposure, sector level net equity exposure, and net fixed income allocation by sector and credit quality category. Additionally, frequent communication with the hedge funds is undertaken by Staff and the HFA to understand the largest positions in the fund.
3. Leverage – The underlying hedge funds may use leverage, which enables them to gain financial exposure greater than invested capital.	LACERA does not permit excessive use of leverage in the Program. Appropriate leverage levels are dependent on the type of strategies used, the degree to which positions have offsetting risks, and the volatility of the assets held in the fund. The leverage ratio at the strategy level is not permitted to exceed 4.0x for hedged credit, event driven and hedged equity, 5.0x for multi-strategy, 8.0x for relative value, and 20.0x for macro and other tactical trading strategies. Portfolio-level leverage is monitored to manage the overall risk level of the Program. Only leverage derived from hedge fund managers' positions is permitted and no additional leverage will be added at the portfolio level.
4. Quantitative Risk – Hedge funds are exposed to a number of quantifiable market risks (e.g., beta and volatility levels).	LACERA's HFAs measure quantitative risks in the Hedge Funds Program through the use of their risk measurement system(s). Risk is evaluated at both the manager level and portfolio level to comply with this policy. The system(s) are used to identify unintentional risks in the portfolio which can be reduced through diversification and to identify portfolio changes which would reduce undesired risk levels while maintaining Program objectives. Other risk analyses used include scenario analysis to determine how the portfolio might behave in certain unfavorable market environments and value-at-risk analysis to identify the potential for losses in severe downside cases.

5. Operational Risk – Hedge fund investments are made through separate legal structures such as limited partnerships. Therefore, additional operational risk can arise when assets leave LACERA's custody.	LACERA invests only in hedge funds where an operational due diligence review determines that the funds' control and compliance environments are sufficient for investment. LACERA invests in funds that are administered by independent third parties, have assets that are held in custody by third parties, and are audited by reputable third parties. The valuation policies of the hedge funds are reviewed periodically to make sure that they are sufficiently strong.

2. Investment Exposure Parameters

At the portfolio level, measurable parameters are employed to mitigate some of the risks that might lead to portfolio losses.

For HFoF portfolios, risks are managed by investment guidelines in place for each portfolio. Though not included in this document, they are consistent with or more strict than the Program-level risk constraints in Section II, Subsection 1, Risk Management, of the OPP.

For LACERA's direct hedge fund portfolio, risk management will be governed by the risk parameters appearing below. Note that this portfolio may be out of the range of these parameters temporarily as LACERA builds its direct hedge fund portfolio to reach the 4% target allocation by the fourth quarter of 2019.

Additionally, beyond the time when the 4% allocation is reached, fund notification period and redemption terms may prevent LACERA from immediately remediating an exposure outside of these parameters. LACERA will take prompt action to remediate any exposures outside the parameters.

LACERA Direct Hedge Fund Portfolio Risk Parameters

Risk Limits:

Estimated portfolio equity beta[12]	Not to exceed 0.20%
Target range of standard deviation	3-8%
Portfolio-level rate of Return at Severe Case Loss[13]	> -10%

[12]Based on forward looking estimates or realized performance measures relative to the MSCI All Country World Index.

[13]Return at Severe Case Loss is determined by applying a consistent measure of an unexpected negative return event for each fund (e.g., downside returns at a two standard deviation event), while applying some level of portfolio correlation by strategy (e.g., 0.4) which implies some level of diversification benefit across strategies.

Maximum Leverage by Investment Strategy Category:

Event Driven (excluding Credit)	4x
Relative Value	8x
Hedged Equity	4x
Macro (Directional/Tactical)	20x
Hedged Credit	4x
Multi-Strategy	5x

Number of Investment Managers: The direct portfolio is expected to have between eight and twenty individual hedge funds.

Size of Investments: The minimum size of a hedge fund investment will be $5 million, while the maximum size of investment made will be 20% of LACERA's direct hedge fund market value. For the purposes of this policy, uninvested amounts that bring LACERA's total direct hedge fund investment up to the 4% strategic policy allocation target shall be considered when determining the maximum investment.

Partnership/Investment Management Organization Limits: LACERA's share in a single hedge fund partnership or other entity structure will not exceed 35% of that organization's total commitments from all limited partners.

LACERA will limit maximum Program investments to any investment management organization such that the aggregate investment with that organization across multiple funds is not greater than 20% of LACERA's direct hedge fund portfolio market value. For the purposes of this policy, uninvested amounts that bring LACERA's total direct hedge fund investment up to the 4% policy target shall be considered when determining the maximum investment.

Liquidity Limits: The portfolio may not invest so that more than 40% of the portfolio value is in funds that are subject to a remaining "lock-up" period greater than one year.

The portfolio may not invest so that more than 25% of the portfolio value is in funds that are subject to a remaining "lock-up" period greater than two years.

The portfolio may not invest so that more than 10% of portfolio value is in funds that are subject to a remaining "lock-up" period greater than three years.

The portfolio may not invest any capital in funds that require a "lock-up" period greater than five years.

Minimum capital invested as a percent of portfolio asset value in funds where full or partial liquidity is available within one quarter (excluding notification periods and after expiration of lock-up periods) is 40%.

Minimum capital invested as a percent of portfolio asset value where liquidity is available within one year (excluding notification periods and after expiration of lock-up periods) is 65%.

Side Pocket Investments: The portfolio is prohibited from investing in funds that make illiquid, "side pocket,[14]" or "designated" investments. Exceptions are allowable in the following cases:

- When the hedge fund offers investors the ability to opt-out of side pocket investments, in which case LACERA will make such election.
- When the hedge fund documents are silent about the ability to invest in side pocket investments, but LACERA and the HFA reasonably expect that the hedge fund manager will not make side pocket investments.
- When the hedge fund documents allow the ability to invest in side pocket investments, but LACERA and the HFA reasonably expect that the hedge fund manager will not make side pocket investments.

3. Prohibited Investments

Hostile Takeovers: LACERA avoids investment strategies that primarily involve hostile takeovers, defined as acquisitions opposed by the board of directors of the target company.

LACERA Hedge Funds Privatization Policy: LACERA avoids investing in hedge funds that are dependent on privatization strategies. LACERA does not aim to promote privatization of public jobs through its Hedge Funds Program.

When performing due diligence prior to making the initial investment in a fund for the direct hedge fund portfolio, Staff and/or the HFA, as applicable, will use reasonable efforts to ascertain the following:

- Whether the fund's main investment strategy includes the privatization of jobs held by LACERA members, and
- Whether other funds operated by the investment management organization, if any, have invested in companies dependent upon privatization of jobs held by LACERA members.

[14]Side pocket investments in a hedge fund are usually less liquid than the remainder of the fund and are therefore accounted for differently. Generally, unlike the remainder of the fund, interests in these investments are allocated to investors at the time they are made and not to any future investors. Even if redeeming out of a fund, an investor may not be able to redeem out of its side pocket investments until those investments are realized.

4. Investment Vehicle Guidelines

Limitation of Liability:

LACERA anticipates that its investments in this Program will take place through pooled investment vehicles that limit its liability to the amount of its capital commitment to the fund. LACERA, or its external legal advisors, will review fund documents before investment to determine that they are governed by the laws of a jurisdiction that recognizes and preserves investors' limited liability.

Taxability: LACERA, or its external legal advisors, will also review fund documents and consider the jurisdictions in which the funds are formed to confirm that they are "tax neutral."

5. Legal

Investments are made, managed, and redeemed in compliance with applicable federal, state, and local country-specific laws. Qualified legal counsel selected by the Legal Office, or Legal Office staff, reviews or negotiates fund documents, side letters, and other legal documents associated with investments.

6. Derivatives

Given that hedge fund managers may have discretion to use short selling, leverage, and derivatives, LACERA's Derivatives Policy will not apply to Hedge Funds Program investments.

7. Fees

LACERA requires fee transparency from its investments in hedge funds, specifying the amount of management fees and accrued performance fees which affect LACERA's net performance. LACERA is complying with new California legislation that requires disclosure of hedge fund fees.

SECTION III – PROGRAM PROCEDURES

Investing in hedge funds requires unique investment procedures. This section defines and explains the methodologies used when investing in this Program.

1. Capital Planning

For each calendar year, a Hedge Funds Annual Investment Plan ("HFAIP"), will establish a pace of investing that will result in an allocation that will fall within the target allocation range. Over the next few years, the focus of the HFAIP will be on new allocations to managers to fully fund the direct hedge fund portfolio. LACERA currently invests in diversified fund of funds and direct hedge funds.

2. Sourcing Investments

Currently the HFoF managers source investments through the resources of their manager research staffs. For the direct portfolio, LACERA and the HFA will source potential investments and identify those that meet the Program's selection criteria and performance goals. All investment opportunities that meet the established criteria and goals will be considered.

LACERA will avoid undue fund or manager overlap or concentration between LACERA's direct hedge fund portfolio and the underlying HFoF portfolio. If LACERA holds or is preparing to hold a fund or manager in its direct hedge fund portfolio, LACERA may prohibit the HFoF managers from holding or adding that fund or manager, or may require the redemption or transfer of a fund or manager already held in a HFoF portfolio.

Methods of sourcing prospective investments include, but are not limited to, the following:

- Meeting investment managers in LACERA's, the HFA's, or investment manager's offices,
- Accessing the market intelligence or databases from the HFA(s) or other sources,
- Referencing funds already approved for investment by an HFA or HFoF manager,
- Meeting with placement agents who represent investment managers,
- Attending investment conferences to meet investment managers,
- Cold-calling potential investment managers, and
- Reading industry publications to keep abreast of people and fund news.

3. Conducting Due Diligence

By conducting due diligence, LACERA and the HFA/HFoF manager pursue favorable investments and reject those that do not meet the Program's criteria. Major factors to be considered include, but are not limited to, the following:

- Experience and cohesiveness of the investment manager or principals involved,
- Depth of resources at the investment management organization, including personnel and technology,
- Soundness of the investment manager's strategy,
- Attractiveness of the strategy in the current market environment and the manager's ability to capitalize on it,

- Assessment of the expected risk/return profile of the strategy, including volatility and expected diversification benefits,
- Fit and appropriateness of the investment for inclusion in LACERA' s portfolio,
- Manager's knowledge of the securities or instruments used in the investment process,
- Appropriateness of the investment manager's risk management practices,
- Transparency of manager with respect to the strategy,
- Financial health and sustainability of the investment management firm,
- Attribution of the investment manager's track record to skill rather than market factors,
- Compliance with LACERA's guidelines,
- Compliance with all national, state, and local financial, regulatory, and legal requirements and evaluation of any audit reports,
- Observations and findings of a recent full operational due diligence review by the HFA or an external provider which investigates the manager's operating, control, and compliance environments,
- Consistently positive references and background checks on the investment management firm and key personnel,
- Appropriate level of the investment manager's Environmental, Social, and Governance risk analysis in place, and
- Approach to diversity and inclusion at the investment manager organization.

4. Addressing Conflicts of Interest

LACERA and the HFA will not recommend/make any investment until all identified real and potential conflicts of interest have been assessed and mitigated to the extent deemed appropriate.

5. Structuring and Negotiating Key Terms, Provisions, and Fees

Staff will negotiate terms and provisions and structure fees so as to provide maximum investor protection and value.

LACERA will consider opportunities to lower fees that some managers may offer for larger allocations, or for extended lock-up terms. Staff may recommend the Board approve exceptions to the policies in this document (e.g. limitations on amount of portfolio value which is subject to remaining lockup periods of greater than two years) for certain hedge funds in order to receive lower fees. LACERA may also consider fee arrangements with a lower management fee, but potentially higher performance fee. LACERA will take into consideration the fee breaks available through its HFA relationship.

6. Approving Investments in the Direct Portfolio

Consistent with LACERA's current governance model, all direct hedge fund investments will be recommended by staff and the HFA and will be subject to Board approval.

Any staff recommendation of a direct hedge fund investment for Board approval will be accompanied by an opinion memo from an HFA. This memo will address investment merit, risks, fit with LACERA's portfolio, objectives, and constraints, and an assessment of the fund's operating, control, and compliance environment.

7. Rebalancing and Redeeming Funds in the Direct Portfolio

Investments in a direct hedge fund portfolio require the flexibility to rebalance the portfolio and terminate managers in a timely manner, within the terms of the notification period and fund redemption schedule for each fund.

In order to rebalance the portfolio to take advantage of changes in market opportunities or reflect evolving views on a manager, LACERA will need to add to or partially redeem from certain funds from time to time. When funds are recommended for approval by the Board, staff will propose an initial investment amount and maximum allocation. LACERA staff may add capital to or reduce amounts invested with already approved managers as long as the value of the new investment amount remains below the maximum allocation amount. A summary of fund additions and redemptions will be reported to the Board periodically through regular quarterly reporting and the monthly CIO Letter.

LACERA may also need to take rapid action to terminate an investment manager for various reasons that include unexplained poor performance, staff turnover, change in fund strategy, evidence of unethical manager behavior, or the existence of more attractive opportunities elsewhere. Staff may terminate funds by requesting a full redemption at the next available redemption period and will promptly report terminations to the Board.

8. Monitoring and Reporting Portfolio Performance

Use of Third Party Administrators in Performance Reporting: In order to provide additional monitoring, independent of reporting provided by HFoF managers, and to provide specialized accounting services for its direct hedge fund portfolio, LACERA requires the use of third party Administrators. Administrators are responsible for accounting for all investor-level activity in a hedge fund portfolio, reporting official independent portfolio valuations and performance on a monthly basis, and reporting interim monthly valuations as required by Staff or the HFoF manager. The selection of Administrators varies by portfolio.

Grosvenor Capital Management ("GCM") is a HFoF manager that uses partnership structures to hold underlying funds for its three portfolios and acts as general partner for its partnerships. As general partner, GCM is responsible for selecting and overseeing the Administrator for these partnerships, and that Administrator delivers valuation and performance reports for each partnership directly to LACERA and its Custodian.

For the Goldman Sachs Asset Management ("GSAM") HFoF portfolio, where LACERA holds the fund interests directly, the fund of funds manager acts under a discretionary Investment Management Agreement. For the GSAM portfolio, LACERA has procured International Fund Services, LLC ("IFS"), a wholly owned division of State Street, LACERA's Custodian, to act as a portfolio-level Administrator. LACERA may also substitute the Custodian as Administrator for the direct and GSAM portfolios or otherwise evaluate alternative solutions.

Reporting to LACERA's Staff: The Administrators track capital flows, measure returns, and provide monthly portfolio performance reports to LACERA. Additionally, the HFoF managers provide monthly and quarterly reporting with analyses regarding the portfolios they manage for LACERA. Individual fund managers provide various forms of monthly, quarterly, or annual reports regarding fund positioning, performance, and outlook.

Calculation of Composite Returns: LACERA's Custodian, State Street, receives portfolio values from the Administrators and calculates multiple portfolio composite returns and the Hedge Funds Program composite return. LACERA's hedge fund performance is consolidated into the Total Fund performance on a one-month lagged basis. This approach allows the Administrator time to capture the closing period cycle for the underlying hedge funds, which have a valuation cycle that often exceeds the global custodian's monthly cutoff for unlagged performance. LACERA may remove the lag in the future if it can obtain sufficient performance data for the hedge fund program within its normally monthly closing cycle.

Reporting to the Board: Staff shall issue quarterly portfolio performance reports to the Board. In addition, staff and at least one of the HFAs shall report to the Board at least annually on the performance and status of the Program. Reports shall include, but not be limited to, such items as the following:

- Risk and return across the Program and its portfolios,
- Summary of investment portfolio performance and its relation to overall market performance,

  Program impact on the Sharpe ratio of the Total Fund,

- The general investment environment,
- Allocations across different strategies of hedge funds,
- Capital activity such as new commitments, contributions, redemptions, and terminations made since the last report,
- Summary of new investments and redemptions by strategy, and

  Compliance with applicable LACERA policies/risk limitations.

Monitoring Adherence to Strategy: Staff shall monitor the type, amount, and allocation of investments to ensure that the strategy set forth in this document is adhered to. LACERA expects staff and and any HFoF managers to strictly adhere to the ranges set forth in this document, to any other applicable portfolio guidelines, as well as to the investment guidelines as set forth in the HFAIP or as agreed upon from time to time by LACERA and any HFoF managers.

9. Implementation Using Separate Accounts or "Funds of One"

LACERA will explore the use of structures which include directly managed separate accounts or "funds of one[15]" that allow LACERA greater operational control over its direct hedge fund investments. The advantages of these structures are that they allow for greater control over assets, lower operational costs, an enhanced negotiating position for lower management and performance fees, full transparency, and an enhanced comfort to take on emerging managers. The disadvantages are greater operational complexity for LACERA and an unwillingness of some fund managers to add to their own operational risk and complexity with these structures. While these structures provide some overall improvements to LACERA, a fund manager's unwillingness to adopt these structures will be considered but not generally used to exclude funds from recommendation.

10. Planning for a Hedge Fund Emerging Manager Program

In 2019, LACERA will also explore strategies through Committee and Board discussions for constructing an emerging manager hedge fund portfolio. Such strategies may include converting all or a portion of an existing Diversified HFoF portfolio mandate to an Emerging Manager HFoF portfolio mandate. This portfolio would follow policies and objectives for emerging manager portfolios that already exist in LACERA's other asset categories.

SECTION IV – SUMMARY OF ROLES AND RESPONSIBILITIES

The roles of the Board, staff, HFA, Hedge Fund of Funds Manager, Administrator, Custodian, and the General Consultant are summarized below:

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[15] A "Fund of One" structure is a customized investment vehicle such as a Limited Partnership for which LACERA would be the sole limited partner.

1. Board Responsibilities

    - Review and approve the Hedge Funds Objectives, Policies, and Procedures,

    - Review and approve the HFAIP,

    Review performance of the Program with the HFA and/or staff at least annually

    - Review and approve direct allocations to externally managed funds and fund of funds mandates, and

    - Refer hedge fund investment opportunities to staff for evaluation, either directly or with the assistance of the HFA.

2. Staff Responsibilities

    - Develop, evaluate, review, and make recommendations to the Board on the Hedge Funds Objectives, Policies, and Procedures,

    - Review the HFAIP at least annually, recommending changes to the Board as appropriate,

    - Monitor and report on the activities of the HFAs to the Board,

    - Conduct searches for HFAs as authorized by the Board,

    - Source, screen, evaluate, and recommend investments to the Board in consultation with the HFAs,

    - Perform investment due diligence on prospective investment managers and investment opportunities that potentially fit the objectives and constraints of the Program,

    - Review with an HFA the operational due diligence findings for managers recommended by staff,

    - Monitor the investment managers in the direct portfolio on an ongoing basis, and consider their replacement with other more attractive investment opportunities,

    - Ensure that adequate measurement systems are implemented to monitor the performance and fees of the Program,

    - Meet with the HFA and the Board at least annually to review Program performance, allocation to the various hedge fund portfolios and other parameters, and other issues that arise,

    - Assure that LACERA has appropriate legal counsel resources to work with staff to review terms and conditions on all proposed investment vehicles,

- Document due diligence procedures undertaken for recommended investments, and

- Maintain internal processes for administering LACERA's role in financial operations of direct and HFoF portfolios.

3. HFA/Hedge Fund of Funds Manager Responsibilities

- Act as fiduciary throughout all phases of the investment process, as overseen by LACERA that may include investment sourcing, consideration, evaluation, recommendation, negotiation, reporting, and monitoring,
- Assist LACERA Board and Staff in identifying potential investment opportunities, conducting due diligence, and monitoring investments,

- For the direct portfolio, provide a written memo and appear at Board meetings in reference to potential fund investments recommended by Staff,

- For the direct portfolio, provide an operational due diligence report addressing the operating, control and compliance environment related to funds and investment management organizations recommended by staff,

- Make investment selections within approved fund of funds mandates,

- Serve the interest of the Board in support of its fiduciary obligation to LACERA,

- Carry out strategic or portfolio-based initiatives as directed by the Board,

- Review Draft HFAIP,

- Provide portfolio performance reporting and evaluation for discretionary portfolios,

- Meet with the Board and staff at least annually to review performance of the hedge fund portfolio(s) and the Program,

- Provide the Board and staff with ongoing educational presentations and/or materials covering market conditions and developments as requested,

- Proactively disclose any perceived or actual conflicts of interest which become apparent to the HFA, and

- With respect to the Grosvenor HFoF: act as general partner in HFoF partnership structures and oversee third party administration, perform cash management for fund of funds, and properly oversee all partnership functions.

4. Administrator Responsibilities

- Maintain accounting records and provide timely official portfolio positions to the Custodian, LACERA, and, if applicable, the HFoF manager,

- Calculate monthly performance of each portfolio and provide this data to the Custodian and LACERA,

- Provide interim valuation and performance estimates of each portfolio to LACERA and, if applicable, the HFoF manager,

5. Custodian Responsibilities

- Calculate performance of multi-portfolio hedge fund composites and of the Program over various time periods, and

- Provide all Hedge Funds Program performance figures that are consolidated into LACERA's Total Fund performance.

6. General Consultant Responsibilities

- Review the OPP and make any recommendations,

- Review the HFAIP annually,

- Review Program-level recommendations for compliance with LACERA policy, and

  Report to the Board on any Program issues, as appropriate.

SUMMARY STATEMENT

This document establishes the framework and practices by which the Hedge Fund Program is to be implemented. These objectives, policies, and procedures will be updated annually to meet the evolving needs of the Hedge Fund Program.

August 30, 2018

TO: Each Member
Credit and Risk Mitigation Committee

FROM: Jude Pérez
Principal Investment Officer

FOR: September 12, 2018 Credit and Risk Mitigation Committee

SUBJECT: **CASH OVERLAY MANAGER SEARCH MINIMUM QUALIFICATIONS AND SCOPE OF WORK**

RECOMMENDATION

Approve the proposed Minimum Qualifications ("MQs") and Scope of Work ("SOW") thereby authorizing staff to initiate the Request for Proposal ("RFP") process for a cash overlay manager search.

BACKGROUND

As previewed at the July 9, 2018 Board of Investments ("BOI") offsite, staff proposed the utilization of a cash overlay program. Such a program is designed to reduce cash drag, increase efficiency, hedge currency[1] exposures, and assist in rebalancing.

MANDATE DESCRIPTION

It is common for institutions such as LACERA to set an asset allocation target for cash at 1% or smaller, since cash is expected to generate lower returns than other asset classes over the long term. In order to make benefit payments, pay operating expenses and meet illiquid capital calls, however, it is necessary to maintain a sufficient cash balance. Over time, cash causes a return-based "drag" on performance. Also, the transaction costs and market exposure gaps from rebalancing through physically held securities may cause further performance headwinds. These costs may be minimized, and liquidity and efficiency may be increased, by using liquid index futures to maintain portfolio exposures and reduce the number of physical security transactions.

A cash overlay program is a comprehensive solution intended to help investors achieve their policy objectives more effectively through adherence to detailed investment guidelines. A well-designed overlay program may mitigate risk, such as allocation drift, and have investment objectives that include:

- Best execution and exposure management cost reduction
- Increased expected portfolio returns, liquidity, and flexibility

[1] While LACERA currently utilizes a currency hedging program, this RFP will evaluate consolidating those services with the cash overlay program.

- Enhanced risk control during monitoring and fund exposure
- Reduced tracking errors to the policy benchmark

A cash overlay program may allow LACERA to remain fully invested while retaining all the benefits of "on demand" liquidity. By expanding the investment toolkit and utilizing a cash overlay program, LACERA may better balance liquidity management with more efficiency.

SCOPE OF WORK

1. Securitization
   - Provide cash securitization to allow full market exposure to LACERA's policy benchmark while maintaining cash balances by securitizing it through futures in order to reduce cash drag on the portfolio.

2. Portfolio Rebalancing
   - Have the ability to provide flexible and cost-effective portfolio rebalancing solutions.

3. Currency Management[2]
   - Have the ability to provide currency hedging.

4. Transition Management
   - Have the ability to provide transition management services with the objective to prevent assets from being unexposed to specific market segments during the movement of capital in an effort to reduce cash drag and improve tracking error to the policy benchmark.

5. Customized Exposure
   - Have the ability to provide LACERA the expertise and facility to implement unique exposure needs across the portfolio on a capital and cost efficient manner.

MINIMUM QUALIFICATIONS

1. Must be a SEC-registered investment advisor or exempt from registration. If exempt, must explain the nature of this exemption.

2. Must submit entire Form ADV, including Part 1 and Part 2 brochures and relevant Schedules.

3. Must have at least five (5) defined benefit pension plan clients, of which three (3) are public pension plans each with total plan assets of at least $10 billion as of September 30, 2018.

4. Must have at least $2 billion in total notional assets under management.

[2] While LACERA currently utilizes a currency hedging program, this RFP will evaluate consolidating those services with the cash overlay program.

5. The organization must have at least a seven-year (7) performance track record as of September 30, 2018 for the proposed overlay services to institutional investors.

6. The organization must conform to Global Investment Performance Standards for performance reporting.

PROPOSED TIMELINE

The proposed RFP timeline (**Table 1)** seeks to ensure a thorough and thoughtful process that efficiently enables LACERA to engage market-leading cash overlay managers.

Table 1 Proposed RFP Timeline

Phase	Steps	Actions	Firms in Process (Est.)	Timing	Status
I	**RFP Design and Launch**	- Codify and gain Board approval of Minimum Qualifications, Evaluation Criteria, and Scope of Work - Publish the RFP document	N/A	Sep-Oct/18	In process
II	**RFP Evaluation**	– Staff to review and rank RFP responses, select semi-finalists	3-8	Nov/18	Not started
III	**Semi-Finalist Evaluation**	– Staff to conduct in-person interviews, complete reference calls	3-4	Dec/18	Not started
IV	**Finalist Recommendations**	- Staff presents to the Board a review of the RFP process and finalist selections - Finalists present to the BOI - BOI selects manager	1-2	Jan-Feb/19	Not started

CONCLUSION

Staff anticipates the proposed MQs and SOW for the cash overlay manager search will attract qualified candidates. Therefore, with the Boards approval of the MQs, staff will issue an RFP for a cash overlay manager.

Noted and Reviewed:

Jonathan Grabel
Chief Investment Officer

JP:cq

MEMORANDUM

To: LACERA Board of Investments

From: Stephen McCourt, Leandro Festino, Tim Filla
Meketa Investment Group

Date: September 4, 2018

Re: Cash Overlay Manager Search Minimum Qualifications and Scope of Work

Meketa Investment Group is in agreement with staff's recommendation to conduct a search for a cash overlay manager, as well as the proposed Minimum Qualifications ("MQs") and scope of work ("SoW).

Cash overlay programs were addressed by staff at the Board of Investment's most recent retreat in July, 2018. Typically, these programs are designed to reduce cash drag and increase efficiency, and may be expanded to hedge currency exposures and assist in rebalancing. These four objectives are appropriate for LACERA and are the ones staff recommends, and we consent.

It should be noted, however, that these potential benefits come with risks, as all investments present trade-offs. While the benefits, described in detail in staff's memo, outweigh the risks, it is appropriate for the Board to be aware of the key risks encountered in cash overlay programs, most notably the risk of cash outperforming a variety of market returns. Typically, during a downturn cash holds up its value, but most risk assets suffer losses. By using futures to obtain market exposures, the cash position would be subject to market volatility, and losses. In addition, another risk is margin/liquidity calls. Future positions that move against an investor result in calls for additional capital or in closing positions at a loss. This situation could happen at a time when the overall Pension Fund is also declining in value.

In conclusion, we agree with Staff recommendation to initiate a search for a cash overlay manager. We would be pleased to elaborate on this recommendation at the upcoming Board meeting in September, and assist both staff and the Board during the coming months in matters related to this search. In the meantime, if you have any questions or would like additional information, please call us at (760) 795-3450.

LF/srt

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