

# LIVE VIRTUAL COMMITTEE MEETING



TO VIEW VIA WEB



TO PROVIDE PUBLIC COMMENT

You may submit a request to speak during Public Comment or provide a written comment by emailing [PublicComment@lacera.com](mailto:PublicComment@lacera.com). If you are requesting to speak, please include your contact information, agenda item, and meeting date in your request.

**Attention:** Public comment requests must be submitted via email to [PublicComment@lacera.com](mailto:PublicComment@lacera.com) no later than 5:00 p.m. the day before the scheduled meeting.

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION  
300 N. LAKE AVENUE, SUITE 650, PASADENA, CA

## AGENDA

A SPECIAL MEETING OF THE EQUITY: PUBLIC/PRIVATE COMMITTEE  
OF THE BOARD OF INVESTMENTS AND BOARD OF INVESTMENTS\*  
LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

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

8:00 A.M., WEDNESDAY, DECEMBER 9, 2020

This meeting will be conducted by teleconference under the Governor's Executive Order No. N-29-20.

Any person may view the meeting online at  
[https://members.lacera.com/lmpublic/live\\_stream.xhtml](https://members.lacera.com/lmpublic/live_stream.xhtml)

*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 Equity: Public/Private Committee Meeting of November 5, 2020.

III. PUBLIC COMMENT

(\*\*\*)You may submit written public comments by email to [PublicComment@lacera.com](mailto:PublicComment@lacera.com). Please include the agenda number and meeting date in your correspondence. Correspondence will be made part of the official record of the meeting. Please submit your written public comments or documentation as soon as possible and up to the close of the meeting.

You may also request to address the Boards. A request to speak must be submitted via email to [PublicComment@lacera.com](mailto:PublicComment@lacera.com) no later than 5:00 p.m. the day before the scheduled meeting. Please include your contact information, agenda item, and meeting date so that we may contact you with information and instructions as to how to access the Board meeting as a speaker.)

December 9, 2020

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#### IV. NON-CONSENT

- A. Recommendation as submitted by Ted Wright, Principal Investment Officer, Ron Senkandwa, Investment Officer, Jeff Jia, Sr. Investment Analyst: That the Committee recommend that the Board of Investments approve the Global Equity – Review of Implementation of U.S. Active Management and Manager Search Process  
(Memo dated November 25, 2020)

#### V. ITEMS FOR STAFF REVIEW

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

#### VII. 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. In the event five or more members of the Board of Investments (including members appointed to the Committee) are in attendance, the meeting shall constitute a joint meeting of the Committee and the Board of Investments. 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, make a motion, or second 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.

***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.***

***Persons requiring an alternative format of this agenda pursuant to Section 202 of the Americans with Disabilities Act of 1990 may request one by calling the Board Offices at (626) 564-6000, Ext. 4401/4402, from 8:30 a.m. to 5:00 p.m. Monday through Friday, but no later than 48 hours prior to the time the meeting is to commence. Assistive Listening Devices are available upon request. American Sign Language (ASL) Interpreters are available with at least three (3) business days' notice before the meeting date.***

MINUTES OF THE SPECIAL MEETING OF THE EQUITY:  
PUBLIC/PRIVATE COMMITTEE OF THE BOARD OF INVESTMENTS  
LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION  
300 N. LAKE AVENUE, SUITE 810, PASADENA, CA 91101  
8:00 A.M., THURSDAY, NOVEMBER 5, 2020

This meeting was conducted by teleconference under the Governor's Executive Order No. N-29-20.

PRESENT:           Herman B. Santos, Chair  
  
                          Elizabeth Greenwood, Vice Chair  
  
                          Wayne Moore  
  
                          Gina V. Sanchez  
  
                          David Green, Alternate

MEMBERS AT LARGE:

David Muir  
  
Alan Bernstein  
  
Keith Knox

STAFF, ADVISORS, PARTICIPANTS

Jonathan Grabel, Chief Investment Officer  
  
Christopher Wagner, Principal Investment Officer  
  
Ted Wright, Principal Investment Officer  
  
David Chu, Senior Investment Officer  
  
David Simpson, Investment Officer

STAFF, ADVISORS, PARTICIPANTS (Continued)

Derek Kong, Investment Officer

Cheryl Lu, Investment Officer

Ron Senkandwa, Investment Officer

Jeff Jia, Sr. Investment Analyst

I. CALL TO ORDER

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

II. APPROVAL OF MINUTES

- A. Approval of the Minutes of the regular Equity: Public/Private Committee Meeting of July 8, 2020.

Mr. Moore made a motion, seconded by Ms. Sanchez, to approve the minutes of the regular meeting of July 8, 2020. The motion passed (roll call) with Messrs. Santos, Moore, Ms. Greenwood and Ms. Sanchez voting yes.

III. PUBLIC COMMENT

There were no requests from the public.

IV. NON-CONSENT ITEM

- A. Recommendation as submitted by Christopher J. Wagner, Principal Investment Officer, Derek Kong, Investment Officer, and Cheryl Lu, Investment Officer: That the Committee advance the Private Equity Consultant Request for Proposal, Minimum Qualifications, and Scope of Work to the Board of Investments for approval.

IV. NON-CONSENT ITEM (Continued)

Mr. Santos proposed an amendment to the recommendation to include language that prior to Phase 2 of the search process, the Board Chair appoint a Trustee from the Equity Committee to the search committee. Ms. Greenwood made a motion, seconded by Mr. Santos, to advance the Private Equity Consultant Request for Proposal, Minimum Qualifications, Scope of Work, and Mr Santos' proposed amendment to the Board of Investments for approval. The motion passed (roll call) with Messrs. Santos, Moore, Ms. Greenwood and Ms. Sanchez voting yes.

- B. Recommendation as submitted by the Growth Team: That the Committee advance the Growth Functional Category Biennial Structure Review and the proposed modifications to the Private Equity program as recommended on slide 37 of the attached presentation to the Board of Investments for approval.

Ms. Greenwood made a motion, seconded by Ms. Sanchez to advance the Growth Functional Category Biennial Structure Review and the Proposed modifications to the Private Equity program as recommended to the Board of Investments for approval. The motion passed (role call) with Messrs. Santos, Moore, Ms. Greenwood, and Ms. Sanchez voting yes.

V. EXECUTIVE SESSION

- A. Conference with Staff and Legal Counsel to Consider the Purchase or Sale of Particular, Specific Pension Fund Investments (Pursuant to California Government Code Section 54956.81)
  - 1. Proposed Modifications to Private Equity Program based on the Growth Functional Category Biennial Structure Review (Memo dated October 23, 2020)

November 5, 2020

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The Committee took action to submit a recommendation to the Board of Investments. It will be reported out at a future date in accordance with the Brown Act.

VI. ITEMS FOR STAFF REVIEW

The Committee requested staff to agendize a discussion and recommendation on updating the existing consultant annual review process at a future Board meeting.

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

There was nothing to report during Good of the Order


VII. ADJOURNMENT

There being no further business to come before the Committee, the meeting was adjourned at 9:10 a.m.

November 30, 2020

TO: Trustees – Equity: Public/Private Committee

FROM: Ted Wright, CFA, FRM, PRM, CAIA   
Principal Investment Officer

Ron Senkandwa   
Investment Officer

Jeff Jia   
Senior Investment Analyst

FOR: December 9, 2020 Equity: Public/Private Committee Meeting

SUBJECT: **GLOBAL EQUITY - REVIEW OF IMPLEMENTATION OF U.S. ACTIVE  
MANAGEMENT AND MANAGER SEARCH PROCESS**

### **RECOMMENDATION**

Advance the proposed changes to the investment guidelines as recommended on slide 17 of the attached presentation to the Board of Investments for approval.

### **BACKGROUND**

During the Growth Biennial Structure Review presented in November 2020, staff communicated that they, along with Meketa, will present a series of discussion topics at subsequent Committee meetings. These discussions are aimed at further enhancing the Global Equity portfolio's risk-adjusted performance. The attached presentation (**Attachment 1**) covers three topics: 1) assessment of the manager search process, 2) review of implementation of U.S. active management, and 3) evaluation of portfolio management tools. Findings from staff's analysis identified existing tools to mitigate risk exposures within the Global Equity portfolio. As LACERA moves from allocator to investor, prudent management of these exposures will help to ensure that LACERA is compensated appropriately for the risks taken.

Meketa Investment Group ("Meketa"), LACERA's general investment consultant, has provided a memo that concurs with staff's findings (**Attachment 2**).

Attachments

Noted and Reviewed:



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Jonathan Grabel  
Chief Investment Officer

TW:jj:rs



# Global Equity

## Review of Implementation of U.S. Active Management and Manager Search Process

Equity: Public/Private Committee Meeting  
December 9, 2020

Ted Wright, CFA, FRM, PRM, CAIA – Principal Investment Officer

Ron Senkandwa – Investment Officer

Jeff Jia – Senior Investment Analyst



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# Recap of November Committee Meeting

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- Biennial structure review conducted at November Equity: Public/Private Committee Meeting
- Findings from review: U.S. Portfolio has underperformed due to small cap and value tilt
- Follow-up presentations on following topics:
  - Assessment of manager search process
  - Review of implementation of active management
  - Evaluation of new portfolio management tools
  - Analysis of the role of activist managers
  - Study of currency hedging program



# Objectives

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*Explore options to enhance risk/return profile of U.S. portfolio*



- Discuss manager search process
- Review implementation of active management within U.S. portfolio
- Expand use of portfolio management tools

# Assessment of Manager Search Process

## Manager search process – prior to November 2019

- Minimum Qualifications (MQs) focused on historical returns
- Performance MQs below were used for public market searches, per prior LACERA IPS

*“At least 60%, or more, of the quarterly rolling one-year excess returns for the last seven years (15 of 25 observations) must exceed the appropriate benchmark by at least the net of fees excess return expectations for LACERA’s managers in the same mandate<sup>1</sup>.”*
- Consistent with IPS, a three-year performance period was used for the U.S. small cap equity manager search conducted in 2017
  - Time period did not capture a full market cycle
  - Resulted in value-biased managers given strong rally of value stocks at the time

## Updated manager search process – post November 2019

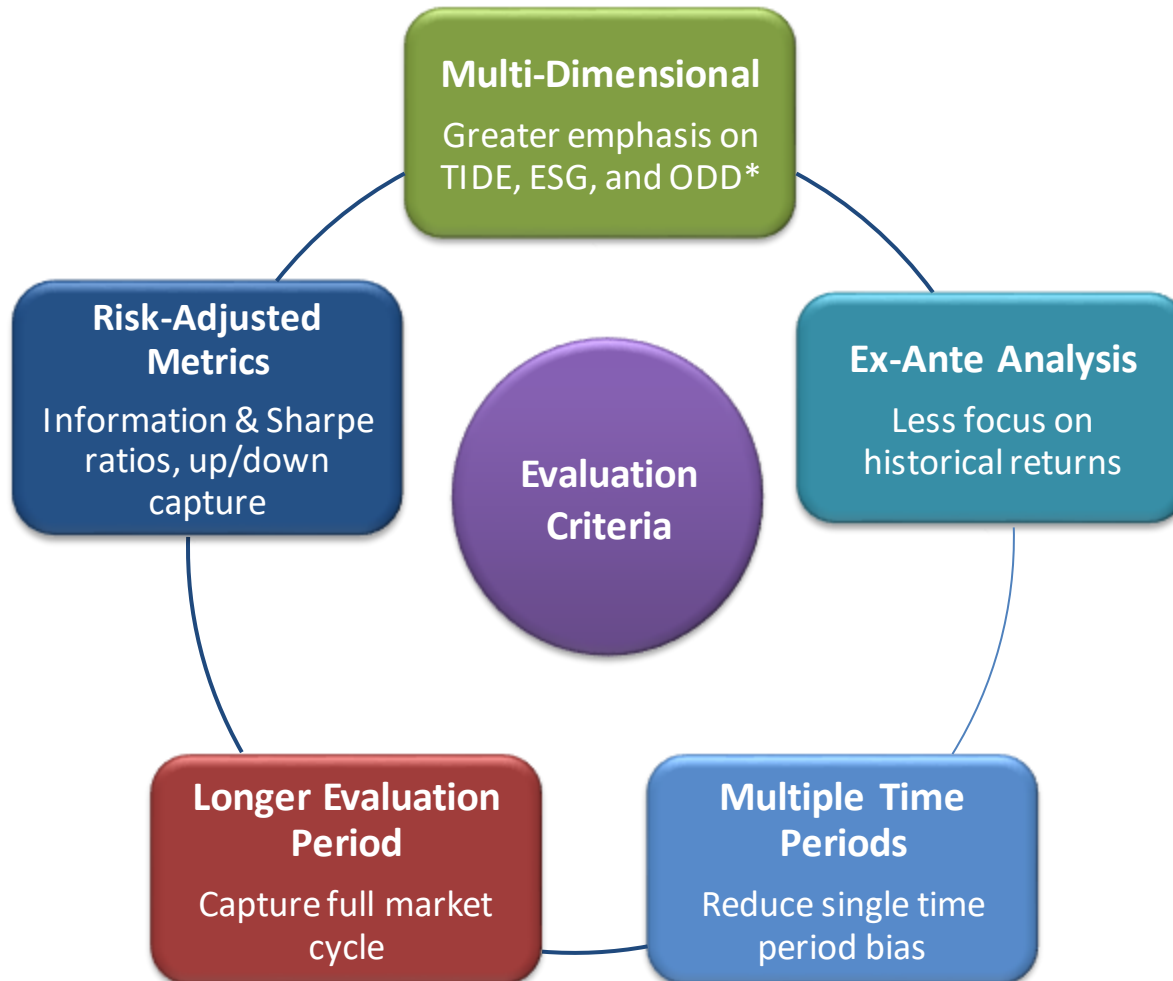
- Revision of IPS and new Procurement Policy remedied most of drawbacks of prior MQs
- New Procurement Policy is designed to be market-aware and new searches will be tailored to the mandate
- Searches will utilize available databases to identify a comprehensive list of managers to optimize responses to RFPs

<sup>1</sup> With the exception of U.S. and international small cap managers: quarterly rolling one-year excess returns for the last three years.

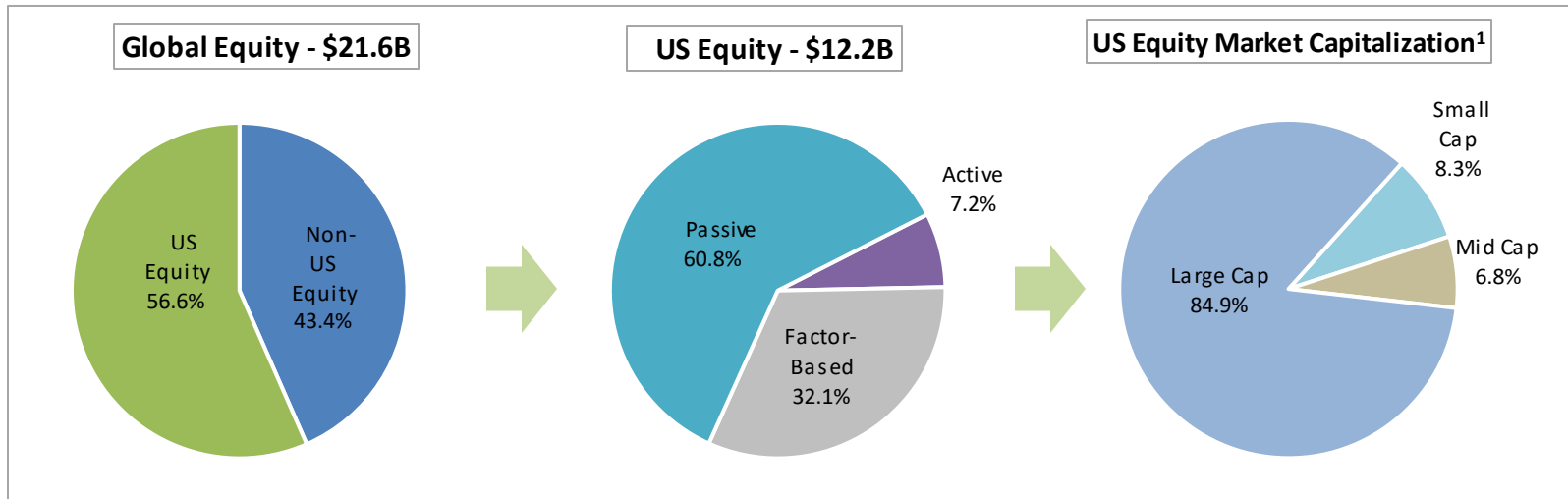


# Assessment of Manager Search Process (Cont'd)

## Broaden Evaluation Criteria:



# Implementation of U.S. Active Management



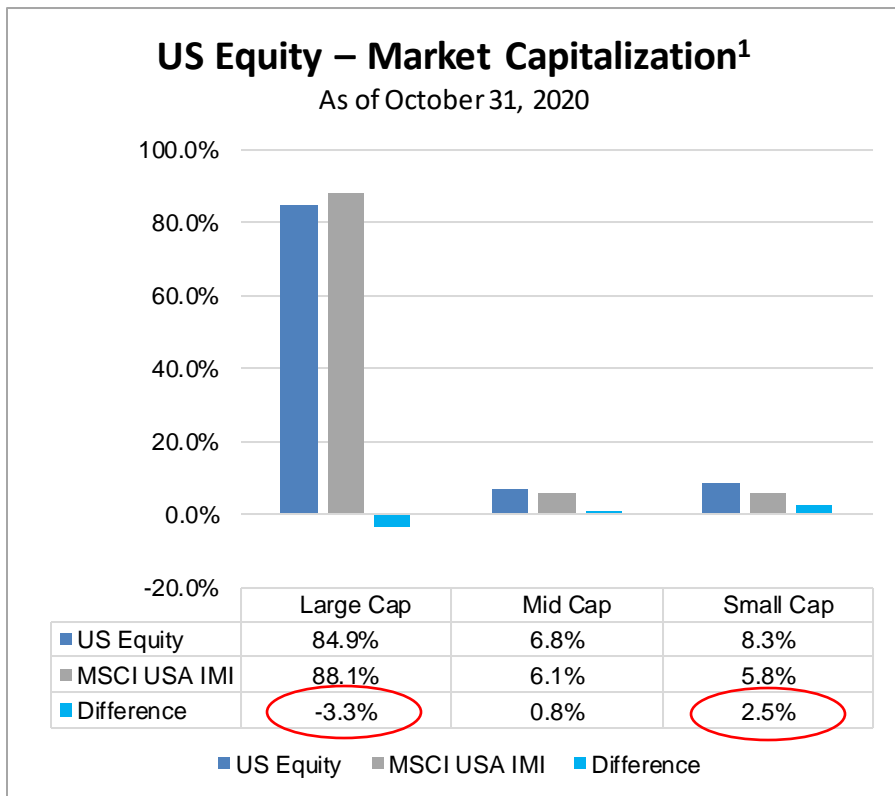
As of October 31, 2020.

- Majority of portfolio is allocated to Passive and Factor-Based
- Passive and Factor-Based allocations reflect efforts to improve portfolio efficiency
- Active management is implemented almost exclusively through small cap and SMID<sup>2</sup> managers

<sup>1</sup> Market cap breakpoints based on LACERA custom breakpoints and may differ from those of MSCI. As of October 31, 2020.

<sup>2</sup> SMID - Small and Mid Capitalization stocks as defined by the Russell 2500 Index.

# Implementation of U.S. Active Management (Cont'd)



- U.S. portfolio is overweight small caps and underweight large caps relative to benchmark
- Overweight to small caps is driven by allocation to small cap managers within active portfolio
- Factor-Based manager has tilt to large cap to offset small cap overweight exposure in active portfolio

<sup>1</sup> Market cap breakpoints based on LACERA custom breakpoints and may differ from those of MSCI.





# Implementation of U.S. Active Management (Cont'd)

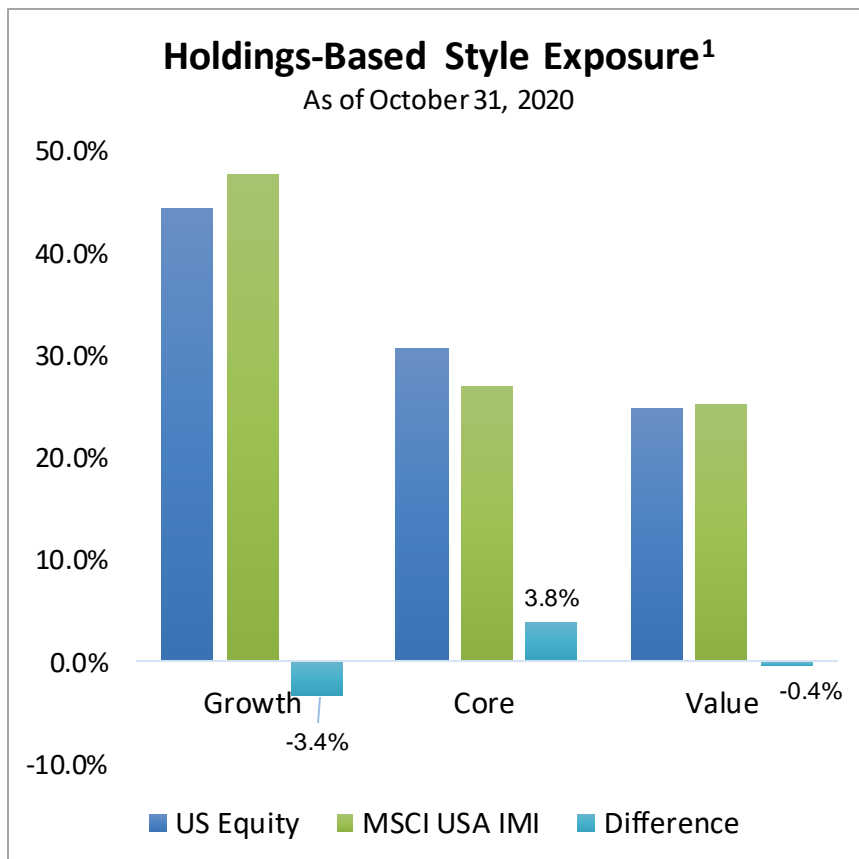
## Style Analysis

As of October 31, 2020

Portfolios	Benchmark	% of Fund	Market Value (\$ Millions)
<b>Large Cap</b>			
JP Morgan US Beta	MSCI USA IMI	81.7%	3,918.3
JANA Partners	S&P 500 Index	1.7%	83.1
<b>SMID Cap</b>			
Frontier	Russell 2500	6.2%	295.8
<b>Small Cap</b>			
QMA	Russell 2000	4.0%	190.9
Systematic	Russell 2000	3.6%	172.2
CornerCap	Russell 2000	1.1%	52.5
Matarin	Russell 2000	1.7%	81.2
<b>US Equity Composite</b>	<b>MSCI USA IMI</b>	<b>100.0%</b>	<b>4,794.0</b>

- U.S. active managers assigned core mandates/benchmarks
- Market dislocations between value and growth stocks may lead managers to favor one style over another in search of alpha
- Decision to tilt managed portfolio to style is active risk undertaken by manager
- Based on assigned mandates, U.S. portfolio is neutral to style

# Implementation of U.S. Active Management (Cont'd)



- U.S. managers' holdings favor core over growth; however, value exposure is roughly in line with the index
- Growth stocks have outperformed value stocks by 32% year-to-date through October 31, 2020<sup>2</sup>
- Manager exposures to style are more dynamic than exposures to market capitalization

<sup>1</sup> Source: FactSet.

<sup>2</sup> As measured by Russell 3000 Growth Index minus Russell 3000 Value Index.



# Implementation of U.S. Active Management (Cont'd)

## Findings



- U.S. portfolio is tilted to less efficient market segments, small cap and SMID cap stocks, in search of alpha
- Pursuit of alpha in these market segments has come at the cost of “beta” (broad market exposure) as small cap stocks have significantly underperformed large cap stocks
- Decision by managers to tilt portfolio away from assigned core benchmark is an active risk decision and potential source of alpha for the manager
- Reducing the small cap overweight would align exposures closer to the benchmark and reduce tracking error

# Expand Use of Portfolio Management Tools

Enhance *risk management* capabilities to reduce *inadvertent exposures*



- LACERA utilizes risk mitigation tools elsewhere within the Global Equity portfolio
  - LACERA uses a 50% passive currency hedge program on the Non-U.S. developed markets portfolio to dampen currency return volatility relative to the U.S. dollar
  - Currency exposures are rebalanced monthly
- Other tools include MSCI's BarraOne risk platform to measure portfolio risk exposures
- In 2019, BOI approved use of Cash Overlay program to rebalance portfolio and better align risk exposures to strategic asset allocation
  - Can use Cash Overlay program to mitigate small cap exposure and to match broad market exposure (beta)

# Cash Overlay Example

## Illustrative Example Only

### No Cash Overlay

U.S. Equity portfolio has a market value of \$10 billion and has an allocation of 5% to large cap stocks versus the benchmark allocation of 7%. The 2% underweight to large caps equals a market value of \$200 million.

#### Scenario 1

If large caps return 20% and the benchmark returns 10%; portfolio will underperform benchmark by **-0.20%\***  $(20\% - 10\%) \times (5\% - 7\%)$ .

#### Scenario 2

If large caps return 10% and the benchmark returns 20%; portfolio will outperform benchmark by **0.20%\***  $(10\% - 20\%) \times (5\% - 7\%)$ .

***Manager alpha and market beta are combined***

### With Cash Overlay

U.S. Equity portfolio uses Cash Overlay to increase exposure to large caps by \$200 million. U.S. Equity allocation to large caps is now in line with benchmark allocation of 7%.

#### Scenario 1

If large caps return 20% and the benchmark returns 10%; portfolio will match benchmark returns **0.00%\***  $(20\% - 10\%) \times (7\% - 7\%)$ .

#### Scenario 2

If large caps return 10% and the benchmark returns 20%; portfolio will match benchmark returns **0.00%\***  $(10\% - 20\%) \times (7\% - 7\%)$ .

***Manager alpha is separated from market beta***

\*Performance is measured relative to benchmark. Large cap return minus benchmark return multiplied by portfolio weight minus benchmark weight. Does not include manager performance.



# Cash Overlay Investment Guidelines

- Establish guidelines to use Cash Overlay program as a risk mitigation tool in Global Equities
- Cash Overlay to align exposures closer to benchmark
  - Not for tactical allocation or market timing



Market Capitalization*	Target Allocation Relative to Benchmark	Action
Large Cap	+/- 1%	Use Cash Overlay to rebalance towards target
Mid Cap	+/- 1%	Use Cash Overlay to rebalance towards target
Small Cap	+/- 1%	Use Cash Overlay to rebalance towards target

Region	Target Allocation Relative to Benchmark	Action
US	+/- 1%	Use Cash Overlay to rebalance towards target
Non-US Developed	+/- 1%	Use Cash Overlay to rebalance towards target
Emerging Markets	+/- 1%	Use Cash Overlay to rebalance towards target



\*Market cap breakpoints based on LACERA custom breakpoints.

# Summary

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## Manager Search Process

- New Procurement Policy improves manager search process
- Updated search process is multi-dimensional
- Manager search criteria more tailored to specifics of mandate

## Implementation of U.S. Active Management

- Current implementation combines alpha and beta
- Need to better align risk exposures to strategic asset allocation

## Expand Use of Portfolio Management Tools

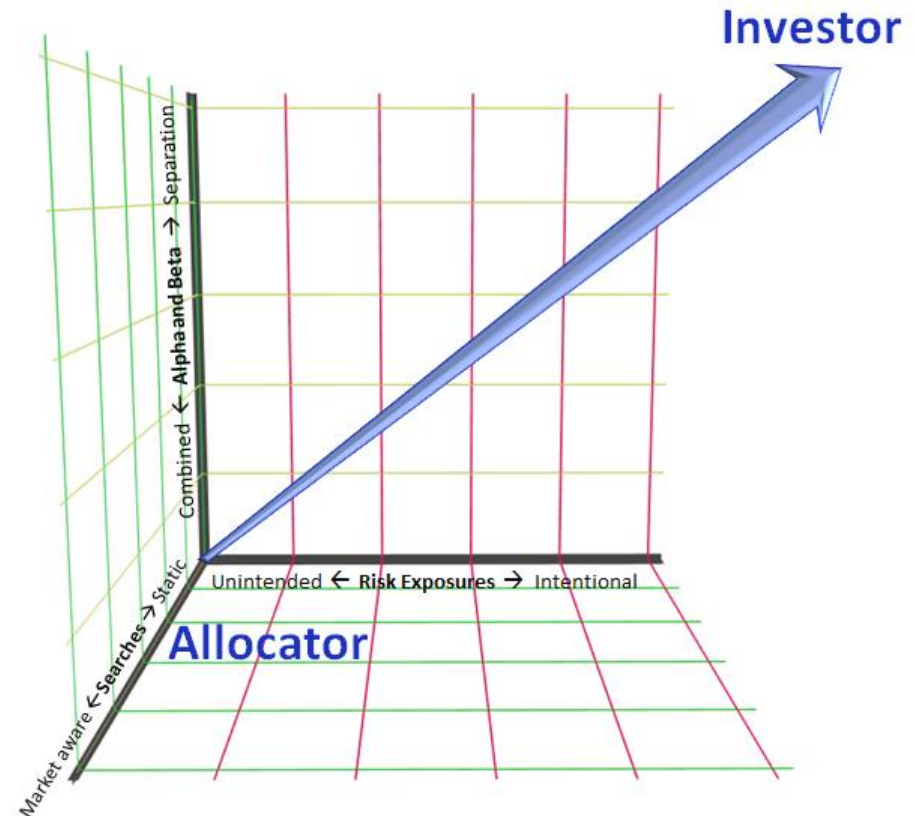
- Embrace risk management tools to acquire real-time knowledge of exposures
- Use **Cash Overlay program** for **intra-asset category rebalancing** to mitigate risk
- Cash Overlay program can be used for small caps and across all global equity risk exposures

# Conclusion

As LACERA migrates from **allocator** to **investor**, the need to prudently manage risk exposures becomes more paramount

Ensures that LACERA is compensated appropriately for risks taken

Separation of alpha from beta will help capture **global equity market beta** and allow **manager selection to be the driver of portfolio alpha**





# Advance to Board

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## Staff proposes advancing the following:

- Adopt investment guidelines changes to:
  - i. Clarify tracking error
  - ii. Affirm currency hedge
  - iii. Establish parameters for Cash Overlay

# Appendices



# Guidelines

	Target
Performance	Meet or exceed the MSCI ACWI IMI Index
Tracking Error	1% – 2.5% rolling 7-year

	Target Allocation	Target Allocation Range
Passive (Index)	60%	40 – 80%
Factor-Based	15%	0 – 30%
Active	25%	10 – 40%

Market	Parameter	Target Allocation Range Relative to Benchmark
Capitalization	Large	+/- 5%
	Mid	+/- 5%
	Small	+/- 5%
Region	United States	+/- 5%
	Developed ex US	+/- 5%
	Emerging	+/- 5%

\*LACERA allows staff and the external managers some latitude outside of the ranges. In the short term, LACERA does not wish to have staff or its external managers constrained by the designated ranges; i.e., fulfilling target allocations will not drive the investment recommendation process. LACERA will invest consistently over time to gain the proper exposures.



# Guidelines (Continued)

	Description
Cash Overlay	If market capitalization or regions deviate +/-1% relative to benchmark, the Cash Overlay program may be used to rebalance market exposures back to target. Rebalancing will not be used for tactical allocation or market timing.
	Description
Currency Hedge Program	50% passive currency hedge (to U.S. Dollar) on the Non-U.S. developed markets foreign currency exposure in accordance with weights of the MSCI World-ex US IMI Index

Prohibited Investment Type	Description
Tobacco	Investment managers should refrain from purchasing tobacco securities when the same investment goals concerning risk, return, and diversification can be achieved through the purchase of another security.
Sudan	Investment managers should refrain from purchasing securities where the company has been identified as doing business in Sudan or with the government of Sudan, when the same investment goals concerning risk, return, and diversification can be achieved through the purchase of another security.
Iran	Investment managers should refrain from purchasing securities where the company has been identified as doing business in Iran's energy sector or with the government of Iran, when the same investment goals concerning risk, return, and diversification can be achieved through the purchase of another security.

\*LACERA allows staff and the external managers some latitude outside of the ranges. In the short term, LACERA does not wish to have staff or its external managers constrained by the designated ranges; i.e., fulfilling target allocations will not drive the investment recommendation processes. LACERA will invest consistently over time to gain the proper exposures.



# Questions and Answers



**MEMORANDUM**

**TO:** LACERA Board of Investments  
**FROM:** Stephen McCourt, Leo Festino, Tim Filla, Alina Yuan  
**CC:** Meketa Investment Group  
**DATE:** November 30, 2020  
**RE:** Global Equity Structure Review

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The Growth Functional Category Biennial Structure Review was reviewed during the November 2020 Equity: Public/Private Committee Meeting. The structure review identified initiatives expected to streamline and strengthen global equity portfolio construction in the upcoming 2021-2022 calendar years. Staff's presentation serves as one of a handful of deep-dive reviews of the global equity portfolio that are expected to follow in future meetings.

In the past few weeks, Meketa and staff have worked closely to evaluate potential enhancements to the Global Equity Portfolio. One of the observations that resulted from staff and Meketa analysis is the underperformance of the US portfolio due to small cap and value tilts. In assessing the manager search process, the Minimum Qualifications (MQs) focused heavily on historical returns and may inadvertently have favored managers with recent outperformance. However, manager performance should instead be considered through full market cycles. The updated Procurement Policy and IPS address future manager searches by tailoring the criteria for each specific mandate.

Staff has also proposed to establish parameters for the cash overlay program as a risk mitigation tool within Global Equities. In addition, staff has proposed a number of changes to the Investment Guidelines including clarifying tracking error and affirming the currency hedge. Since Meketa worked concurrently with staff in each of these initiatives, we naturally concur with the findings and the proposed changes to the Investment Guidelines.

Looking into 2021, we would highlight the following initiatives as considerations for analysis:

- Evaluation of fit of activist strategies in the global equity portfolio.
- Revisiting the role of currency hedge in the global equity portfolio.

We look forward to working with staff on these matters, and discussing our findings and recommendations to the Committee and the Board.

SPM/LF/TF/AY/sf