

BOARD OF INVESTMENTS MINUTES 10-13-10

PRESENT

- Herman Santos, Chair
- John M. Barger, Vice Chair
- Diane Sandoval, Secretary
- William Pryor
- Simon S. Russin
- Joseph Kelly (Sitting in for Mark J. Saladino)
- Michael Schneider
- Leonard Unger

ABSENT

- Estevan Valenzuela

STAFF, ADVISORS, PARTICIPANTS

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

1. PUBLIC COMMENT

None.

2. REPORT ON CLOSED SESSION ITEMS

None.

Chair Santos indicated that item III. Reports would be handled at this time.

3. REPORTS

1. Hedge Fund Education — Presentation Only

- Lisa Mazzocco, Chief Investment Officer, (Memo dated October 6, 2010.)

Ms. Mazzocco provided an executive summary on the hedge fund educational presentations and reported the Board had requested information regarding implementation strategies for a hedge fund program and that a hedge fund manager, a hedge fund consultant, and a hedge fund of funds manager would be presenting before the Board, she introduced Mr. Andrade of AQR Capital Management who followed with his presentation.

1. AQR Capital Management

- Gregor Andrade, Ph.D, Principal

Mr. Andrade, of AQR Capital Management (“AQR”) gave a brief overview on AQR’s historical background and reported that it is an investment management firm focused on quantitatively oriented strategies. About 60% of its \$29.5 billion in assets under management is investment in long-only mandates with the remainder invested in alternative and hedge funds strategies. The firm is based in Greenwich, Connecticut.

Mr. Andrade also provided an educational report on hedge funds and hedge fund investing, reporting on how they performed in the most recent environment. He also reported on the systematic approach to capturing hedge funds “beta”, used by AQR, which approach captures the return and correlation characteristics of major hedge fund categories and systematically creates these strategies at a lower investment management fee using publicly traded securities that are liquid and transparent.

A hedge fund is an alternative investment strategy that seeks to generate attractive returns; with low correlation to traditional stock and bond markets; and less downside risk. Hedge funds differ from other alpha-seeking strategies by employing non-traditional techniques: Shorting; leverage; and derivatives. A hedge fund in a portfolio would seek positive long-term expected return; low correlation to other investments; generally lower sensitivity to economic cycle; better source of active management (fewer constraints) and a natural way to diversify a traditional portfolio.

Hedge fund styles include: Event driven; Fixed income arbitrage; dedicated short bias; convertible arbitrage; equity market neutral; emerging markets; global macro; long/short equity; and, managed futures. The good new about hedge funds is that they offer a diversifying positive expected return which can improve almost any portfolio’s risk-adjusted return. The dark side of hedge funds is: illiquidity; correlation; leverage; crowded strategies (lack of) transparency; and high fees. It was also reported that hedge funds have high and increasing levels of equity market exposure.

Hedge funds significantly outperformed equities over the last 10 years, including the credit crisis. Mr. Andrade also offered an explanation on hedge fund beta and hedge fund beta examples and reported that they provide benefits, attractive returns and diversification. A discussion followed on hedge fund concerns, investment styles and the Report was received and filed.

2. Albourne Partners

- John Claisse, Head of Portfolio Group

Ms. Mazzocco introduced Mr. Claisse of Albourne Partners (“Albourne”) who followed with his presentation on the direct implementation approach to building an institutional hedge fund portfolio. Albourne is a hedge fund consultant and should LACERA pursue a hedge fund portfolio, a consultant such as Albourne would be used to construct a hedge fund portfolio.

Mr. Claisse gave a presentation on building a direct hedge fund program, illustrating an independent specialist consulting model. He reported that Albourne's service focuses on manager research, manager due diligence, strategy research risk analysis, portfolio advisory and industry research. They have experience with many clients globally in developing investment policy statements and investment guidelines strategic plan (three to five year horizon) tactical/implementation plan (one year horizon), working with staff and Board to an investment framework. Also the plan to establish a portfolio construction framework would involve identifying the asset allocation assumption, target return, target volatility and market exposure (correlation). The framework would also involve super-strategy allocations to maintain diversification such as seeking returns by capitalizing on the mispricing of related securities or financial instruments and generally avoid taking a directional bias with regard to the price movement of securities/markets. Consultant model portfolio are constructed to represent a different hedge fund mandate: Conservative, moderate, aggressive, domestic (taxable US investors), and Asia (regional specialist). The portfolios reflect Albourne's view on the optimal mix of strategies to achieve each mandate's objectives as defined by return, risk and correlation.

The target strategy composition of each model portfolio is updated quarterly based on Albourne's quarterly strategy forecasts. Albourne also provided their plan design on their manager selection process and risk analysis. A brief discussion followed on custody concerns and the Report was received and filed.

3. Goldman Sachs Asset Management

- Kent A. Clark, Chief Investment Officer, Hedge Fund Strategies
Alternative Investments and Manager Selection Group

Mr. Clark of Goldman Sachs Asset Management ("GSAM") provided a brief overview on the firm's historical background. GSAM the institutional investment management division of the bank, offers hedge fund of fund services as part of its Hedge Fund Solutions ("HFS") area within its alternative investment business. In other areas of Goldman Sachs the firm also runs its own directly managed hedge funds and offers prime brokerage services to hedge funds. GSAM's focus is the use of hedge fund of funds in implementing an institutional program using hedge fund strategies.

Well resourced teams have the ability to source and evaluate managers that invest across the spectrum of strategies, asset classes, and geographies, including the operational expertise cultivated from experience seeing a variety of organizational practices. With an established relationship network the capabilities of access to limited capacity managers as well as closed managers (via commingled vehicles). It was reported that Hedge funds are a dynamic organization that continuously evolve. Meaningful investment may provide leverage in negotiating preferential fees, liquidity terms and/or transparency. As desired partners for many hedge fund organizations, large funds of funds platforms may be able to shape investment guidelines relating to leverage, position sizing, and stop losses. Established relationship networks and large footprint in the industry give funds of hedge funds an edge in sourcing lesser-known managers and the experience to invest in smaller niche managers with shorter track records. Long term institutional relationships have given rise to the ability to access limited-capacity or closed hedge funds managers.

Mr. Clark also conveyed that long-standing relationships have given rise to regular dialogue between funds of hedge funds and managers and believes that insight allows for superior decision-making in the continual evaluation of manager skill. Fund of hedge funds have the unique ability to implement sector weights in a timely and efficient manner to take advantage of perceived market opportunities. A brief discussion followed on liquidity and transparency concerns and the Report was received and filed. Chair Santos indicated that the Board would return to the regular order of business.

4. ACTIONS ITEMS

1. Recommendation as submitted by Lisa Mazzocco, Chief Investment Officer and James Rice, CFA, Investment Officer: That your Board provide staff with direction regarding a hedge fund program. (Memo dated October 8, 2010.)

Ms. Mazzocco provided an executive summary on the proposed recommendation on hedge fund program and reported that staff was seeking direction from the Board regarding the implementation of a hedge fund program, outlining three options for the Board's consideration: 1) Not to pursue a hedge funds program; 2) Implement a direct hedge funds program; or 3) Retain a hedge fund of funds ("HFoF") manager.

She also reported on the certain issues to be considered before LACERA's entry into hedge funds and reported that a successful hedge funds program require investors to have experienced judgment in structuring and monitoring the funds, evaluating investment risks, and minimizing operational risks, and establishing a hedge fund program would require specialized service providers, such as a consultant or HFoF manager.

Ms. Mazzocco also reported that expanding LACERA's investment program to include hedge funds should reduce the overall volatility of the Fund without materially reducing expected return. The returns for a diversified hedge fund program are not expected to exceed public equity returns but should exceed fixed income returns. Staff anticipates that a hedge fund program should participate in stock market rallies, but not lose as much as equities in down markets.

It was also reported that building a hedge fund program with funds that are uncorrelated to LACERA's existing asset classes should provide additional diversification, thereby reducing total fund volatility. A brief discussion followed. A motion was made by Mr. Unger, seconded by Mr. Santos to give staff direction to have a 1% allocation to hedge funds and do a Request for Information (RFI) as a first step toward investing in hedge funds. The motion carried with Messrs. Kelly, Russin and Ms. Sandoval voting no and Messrs. Barger, Unger, Schneider and Santos voting yes.

2. Recommendation as submitted by Vache Mahseredjian, CFA, Principal Investment Officer, James Rice, CFA, Investment Officer, and Esmeralda del Bosque, Senior Investment Analyst: That your Board invite Credit Suisse Asset Management to interview with your board for a Commodities mandate. (Memo dated October 6, 2010.)

A report was provided on the results of the commodities manager search. The purpose of the search was to implement an increase in the commodities allocation from 2% to 3%. The search was conducted using LACERA's customary two phase process. Phase one consists of staff assessing Request for Proposal ("RFP") responses of the firms that met the Board's approved minimum qualifications ("MQs").

It was reported that eight managers responded to the RFP, but only two of those firms, Credit Suisse Asset Management ("CSAM") and Deutsche Asset Management ("Deutsche"), met the MQs. The most common reason firms did not qualify was they lacked a five-year track record. Also, several firms failed to meet the performance MQs, because they suffered losses in their collateral pools during the 2008 credit crisis. Typically, staff recommends that your Board interview two or three finalists for a mandate. Although the circumstances of this search resulted in a single recommended manager, staff is confident that the search process identified the strongest candidate and the best fit for LACERA. The failure of other managers to reach the finals does not alter the fact that CSAM is a very strong candidate. It was also reported that CSAM's conservative approach could complement LACERA's existing commodities composite by providing diversification and reducing the program's overall risk. A brief discussion followed.

A motion to approve the recommendation was made by Mr. Barger, seconded by Ms. Sandoval. The motion carried with Messrs. Schneider and Russin voting no.

3. Recommendation as submitted by Cynthia Lau, Legislative Affairs Officer: That your Board direct staff to work with LACERA's lobbyist and seek an author to introduce legislation in accordance with the proposal to authorize the Board of Investments to issue subpoenas and subpoenas duces tecum relating to matters within the Board of Investments' jurisdiction. (Memo dated September 29, 2010.)

Ms. Lau provided a brief overview on the proposed legislation to be introduced authorizing the Board of Investments to issue subpoenas and subpoena duces tecum relating to matters within the Board of Investments' jurisdiction. A brief discussion followed.

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

Chair Santos indicated that item VI. Good of the Order would be handled at this time.

5. EXECUTIVE SESSION

1. Public Employee Performance Evaluation (Pursuant to California Government Code Section 54957.)

Title: Chief Investment Officer

The Board met in Executive Session pursuant to Government Code Section 54957 to discuss the performance evaluation of the Chief Investment Officer. The Board reconvened in open session, at which time it was reported for the record that no further report is required.

Green Folder Items

1. Chief Executive Officer's Report.

6. GOOD OF THE ORDER

(For discussion purposes only.)

Mr. Rademacher attended the Board of Supervisors' meeting of October 12, 2010, where they approved the Benefits Replacement Plan with a 3 to 2 vote. The Benefit Replacement Plan agenda item will require a second reading for final approval. Additionally, the Board of Supervisors discussed the Retiree Health Care Program and their intent to pre-fund the Retiree Health Care liability. It is expected that LACERA's Board will be asked to serve as the investment manager for the Retiree Health Care Fund. LACERA staff is working with Los Angeles County Staff to finalize an investment agreement for the Board's consideration.

Mr. Rademacher also reported that two CEO's recently left the California Pension Industry. The CEO/CIO from San Bernardino resigned over an issue of compensation and is now working for Kodak, and locally, Sally Choi from the Los Angeles City Pension Plan is going to work for the Motion Picture Industry.

The Board commended Ms. Mazzocco and staff on the Hedge Fund presentation and on their reports. Mr. Russin reported that he attended the IREI Conference in Singapore and said it was an excellent conference.

7. ADJOURNMENT

4/29/11