

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Page 1

May 28, 2008

The Board of Retirement met in regular session at 9:00 a.m. on Wednesday, May 28, 2008 in the Conference Room of the Contra Costa County Employees' Retirement Association, 1355 Willow Way, Suite 221, Concord, CA.

Present: Richard Cabral, Dave Gaynor, Brian Hast, Paul Katz, Sharon Naramore, William J. Pollacek, Jim Remick, Jerry Telles, and Maria Theresa Viramontes.

Staff: Marilyn Leedom, Retirement Chief Executive Officer; Cary Hally, Retirement Chief Investment Officer; Rick Koehler, Retirement Accounting Manager; Toni Warren, Retirement Administration Manager.

Outside Professional Support: Representing:
Harvey Leiderman Reed Smith LLP
Bob Helliesen Milliman
Tim Price Milliman

Other Attendees:
Luz Casas Contra Costa County Employees' Retirement Association (CCCERA) Staff
Terry Buck Self
Art Mitsutome Self
Dan Heflin ING Clarion
Mike Bean Bean & Associates
Trevor Rozowsky ING Clarion

1. Public Comment

No members of the public offered comment. On behalf of the Board, Hast welcomed back Katz after his lengthy absence.

2. Approval of Minutes

It was **M/S/C** to approve the minutes of the April 30, 2008 meeting. (Yes: Cabral, Gaynor, Hast, Pollacek, Remick, and Telles; Abs: Katz)

It was **M/S/C** to approve the minutes of the May 7, 2008 meeting. (Yes: Cabral, Gaynor, Hast, Pollacek, Remick, and Telles; Abs: Katz)

Viramontes was present for subsequent discussion and voting.

3. Investment Analyst

Hally reviewed his memo that included the history of recruiting for the position of Retirement Investment Analyst. He noted of the six candidates interviewed for the position, there were few qualified candidates, which have a strong work background, a CFA designation and an MBA. He has made an offer to a qualified candidate with strong

qualifications to start on June 2. He noted it has been approximately a year since the position was first created, and requested an increase in the maximum salary range. The increase will enable CCCERA to offer a more competitive package to retain candidates.

There was a motion to accept staff's recommendation.

There was discussion that CCCERA's fund is in excess of \$5 billion and having a qualified candidate to assist the Chief Investment Officer was extremely important. Some noted it was necessary to pay the market price.

There was discussion on public vs. private sector pay, the increase in benefits public sector employees receive and questions if the total compensation was applied to the salary range.

It was *M/S/C* to accept staff's recommendation to increase the maximum salary range approved for the Retirement Investment Analyst by 10%. (Yes: Gaynor, Hast, Katz, Pollacek, Telles, and Viramontes; No: Remick and Cabral)

4. Review of Total Portfolio Performance

Milliman - Bob Helliesen

Helliesen began by noting the first quarter of 2008 was dismal; however since the end of the quarter the fund is up approximately 3.3%, based on the returns of broad market indexes.

There was continued turmoil in the equity markets during the first quarter. Larger capitalization stocks held up marginally better than small capitalization securities. Large capitalization stocks, as measured by the S&P 500, returned -9.5% in the first quarter while the Russell 2000® Index returned -9.9%. The median equity manager returned -9.5% and the broad market, represented by the Russell 3000® Index, returned -9.5%. International equity markets also had negative results in the first quarter, with the MSCI EAFE Index returning -8.8% and the MSCI ACWI ex-US Index returning -9.1%. The U.S. bond market was positive in the first quarter of 2008, with the Lehman Universal Index returning 1.7%, the Aggregate Index returning 2.2% and the median fixed income manager returning 1.7%. The domestic private real estate market continued to post positive results in the first quarter of 2008, with the NCREIF Index returning 1.6%. Publicly listed real estate was also positive with the Dow Jones Wilshire REIT Index returning 2.1%.

CCCERA's first quarter return of -5.0% slightly trailed both the median total fund and the median public fund. CCCERA also lagged the median funds over the past year. CCCERA has out-performed both medians over all trailing time periods two years and longer, ranking in the upper quartile of both universes over the past two through five-year periods.

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Page 3

May 28, 2008

CCCERA total domestic equities returned -10.8% for the quarter, below the -9.5% return of the Russell 3000® and the -9.5% return of the median manager. Of CCCERA's domestic equity managers, Rothschild had the strongest performance with a return of -5.8%, better than the -7.2% return of the Russell 2500® Value Index. Wentworth returned -8.5%, better than the -9.5% return of the S&P 500. Intech Enhanced Plus returned -10.2%, below the S&P 500. Intech Large Cap Core returned -10.5%, also below the S&P 500. ING returned -10.6%, below the S&P 500 and the S&P 500 ex-Tobacco Indexes. PIMCO returned -10.9%, below the S&P 500. Delaware returned -11.2%, below the -10.2% return of the Russell 1000® Growth Index. Boston Partners returned -12.1%, below the -8.7% return of the Russell 1000® Value Index. Progress returned -12.7%, better than the -9.9% return of the Russell 2000® Index. Finally, Emerald returned -14.4%, trailing the -12.8% return of the Russell 2000® Growth Index.

CCCERA international equities returned -9.2%, below the -8.8% return of the MSCI EAFE Index and the -8.8% return of the median international manager. The GMO Intrinsic Value portfolio returned -8.0%, better than the S&P Citi PMI EPAC Value Index return of -9.6% and the median international equity manager. McKinley Capital returned -10.3%, below the MSCI ACWI ex-US Growth Index return of -7.8%, and below the median international equity manager.

CCCERA total domestic fixed income returned -0.8% for the first quarter, well below the 1.7% return of the Lehman Universal and the 1.7% return of the median fixed income manager. AFL-CIO's return of 1.9% slightly trailed the Lehman Aggregate but was above the median fixed income manager. PIMCO returned 2.6%, above the Lehman Aggregate and the median. Western Asset returned -1.4%, below the Lehman Aggregate and the median. ING Clarion (mostly already liquidated) returned 1.9%, better than the high yield fixed income median of -3.3% and the -2.8% return of the Merrill Lynch High Yield Master II Index. ING Clarion II returned -27.8% in the first quarter, far below the ML High Yield II Index and the high yield fixed income median. Nicholas Applegate returned -1.6% versus -2.8% for the ML High Yield II Index and exceeded the high yield median manager.

Lazard Asset Management returned 7.8% in the first quarter, well above the Lehman Global Aggregate return of 6.6% and ranked in the 34th percentile of global fixed income portfolios.

CCCERA total alternative investments returned 4.0% in the first quarter. The Energy Investor Fund reported a return of 233.3%, Bay Area Equity Fund reported a return of 19.9%, Energy Investor Fund II reported a return of 9.9%, Adams Street Partners reported a return of 3.8%, Pathway returned 1.7%, Hancock PT Timber Fund returned 1.3%, and Nogales had a return of -48.6% for the quarter. (Due to timing constraints, all alternative portfolio returns except Hancock PT Timber Fund are for the quarter ending December 31.)

The median real estate manager returned 1.2% for the quarter while CCCERA's total real estate returned 1.5%. The DLJ RECP II returned 5.3%, Prudential SPF-II returned

1.5%, DLJ's RECP III returned 2.3%; BlackRock Realty returned 2.1%, Adelante returned 1.6%, Willows Office property returned 1.4%, Fidelity II returned 1.4%; DLJ's RECP I returned 0.5%, Invesco returned -0.5%, and Invesco Fund II returned -10.0%.

Helliesen explained why Energy Investor UPSF I reported a return of 233.3%, which was the result of marking the current assets to market value. He commented PIMCO had a great quarter on the bond side; however, he recommended placing Emerald on watch for performance with the possibility of placing both ING and PIMCO Stocks plus on watch for performance as well.

It was **M/S/C** to place Emerald, ING Investments and PIMCO Stocks Plus on watch for performance. (Yes: Cabral, Gaynor, Hast, Katz, Pollacek, Remick, Telles, and Viramontes)

It was **M/S/C** to perform an on-site visit to Emerald and PIMCO. (Yes: Cabral, Gaynor, Hast, Katz, Pollacek, Remick, Telles, and Viramontes)

After discussion on Nogales' performance, it was **M/S/C** to place Nogales on watch for performance and to perform an on-site visit. (Yes: Cabral, Gaynor, Hast, Katz, Pollacek, Remick, Telles, and Viramontes)

Staff was asked to put together a full analysis of the Nogales' investment and return to the Board with the information.

There was discussion of the outstanding performance of PIMCO Total Return, Rothschild and Wentworth, Hauser and Violich. AFL-CIO did well and Lazard also did well.

Alternative investments: Adams Street, Pathway, Energy Investors and Bay Area Equity Fund had nice returns for the quarter.

5. **ING Clarion Debt Opportunity Fund III Presentation** - Mike Bean, Dan Heflin, and Trevor Rozowsky

Heflin began by noting they would provide an in-depth market discussion. He stated it is an interesting, however, scary time in the market place. He provided a firm overview, noting that ING Clarion Capital is an SEC registered investment advisor formed in 1995, with more than \$5.0 billion under management; they have a team of 40 professionals with an average of 20 years of experience.

He provided a history of ING Clarion Debt Opportunity Fund I and ING Clarion Debt Opportunity Fund II, noting the differences in the portfolio distribution for each.

Heflin discussed what has triggered the credit crunch; home price depreciation, sub-prime delinquency rates and commercial mortgage BBB spreads.

Heflin noted ING Clarion Capital is sponsoring ING Clarion Debt Opportunity Fund III, the third in a series of opportunity funds to invest in high yield commercial real estate-related debt investments. He then provided ING's investment strategy with project portfolio allocation, total return scenarios with base, upside and downside possibilities. The projected base case is net returns of 16.8%, with the upside scenario of 21.8% and a downside scenario of 2.1%.

Heflin concluded by noting their terms are the same for Fund I, II and III with the first close for Fund III on June 30th, they are targeting \$1 Billion for Fund III. When asked how much ING Clarion employees are investing in the fund, he noted the amount would be the same as Fund I: \$2 ½ million.

6. Action on ING Clarion Debt Opportunity Fund III, LLC

Hally reviewed his memo, analyzing ING Clarion Debt Opportunity Fund I and ING Clarion Debt Opportunity Fund II. Hally also reviewed the impact a commitment to ING Clarion Debt Opportunity Fund III will have on the overall fixed income allocation, and a summary of the key terms of the investment. Helliesen concurs with Hally's recommendation and thinks future excess earnings will come from this investment.

There was discussion if the amount invested would move ING up to managing a major part of the fixed income portfolio. Hally noted he feels comfortable that investing with Fund III would still be a small piece of the overall portfolio.

It was **M/S/C** to accept the recommendation of staff to make a capital commitment of \$75 million to ING Clarion Debt Opportunity Fund III, LLC, subject to a successful on-site visit, contract negotiations and to authorize the CEO to sign any necessary documents; the motion included adopting the fixed income targets as proposed to accommodate this commitment, and to continue with PIMCO as the temporary investment vehicle for uncalled capital relating to this commitment. (Yes: Cabral, Gaynor, Hast, Katz, Pollacek, Telles, and Viramontes; No: Remick)

7. Transition Management Services

It was **M/S/C** to accept the recommendation of staff to authorize staff and the consultant the flexibility to choose the appropriate transition manager for the upcoming fixed income transition from the proposed list of transition managers and to authorize the CEO to sign any necessary documents. (Yes: Cabral, Gaynor, Hast, Katz, Pollacek, Remick, Telles, and Viramontes)

Staff was directed to return to the Board with a pooled group of transition managers for future transitions.

8. Presentation of Asset Allocation Study

Price began by noting the last asset allocation study was conducted in 2005. Asset allocations should be conducted every three to five years and allocation of asset is one of the most important investment decisions made by institutional investors.

The asset allocation study presents a number of alternative asset mixes for consideration that have been developed based on the estimates of asset class returns and risks. Several mixes could be appropriate depending on Board risk tolerance.

As discussed at the Board meeting in February 2008, the asset classes are modeled in two ways for the study. The first approach models the expected return and volatility of US and International (non-US) asset classes separately. This is the approach that has been taken in past studies. The second approach models global asset classes. The rationale for the global approach is that the correlations between domestic and international securities have increased significantly over the past decade. This recent high correlation suggests that asset classes can be modeled on a global scale, and then allocated between domestic and international securities on a market-weighted or other basis.

He noted they find that the current mix is quite efficient, and continues to be a reasonable choice in that it, for all practical purposes, delivers the maximum return that can be attained given the risk taken.

The one issue with the current mix is the expected return of 7.6% under the traditional asset class structure which is 0.2% below the actuarial interest rate assumption of 7.8%. Interest rates on fixed income have declined over the past several years, and return estimates for other asset classes have declined as well. To achieve an expected return of 7.8% requires either a slightly more aggressive asset allocation or added return from active management.

Price noted he assumes that the Board would prefer to adopt an asset mix with an expected return of 7.8%. They have proposed target asset mixes under both the Traditional and Global Asset Class structures that are expected to deliver this rate of return, net of fees. Moving to either mix would involve shifting more money into alternatives and international equities while lowering the domestic equity allocation. He noted they have a slight preference for the global approach, but would be comfortable implementing either approach.

Price provided a definition for long-bonds. There was discussion on having more choices over the next three years with global rather than domestic investing and the affect of inflation was also covered.

9. Action on Asset Allocation Study

Different alternatives to the asset mixes were discussed. Board members were asked their alternative asset mix preference.

The consultants will focus on global mixes in the range of the 6 - 8 mix with lower alternatives and higher real estate. They will return to the Board with the suggested alternatives.

LUNCH

10. Conference Seminar Attendance

- (a) It was *M/S/C* to authorize the attendance of CCCERA's new Investment Analyst, Chu, at the Client Conference, Paladin, June 3 - 4, 2008, Washington, DC. (Yes: Cabral, Gaynor, Hast, Katz, Pollacek, Remick, Telles and Viramontes)

11. Miscellaneous

- (a) Staff Report - Leedom noted, during the Administrator's breakout session at the Spring SACRS Conference, there was discussion regarding the formation of an adhoc committee to work towards review of the '37 Act and compliance with the IRS Code.

Leedom noted she is still working on the contract with Milliman for actuarial audit services. Staff has distributed a Request for Information (RFI) for a salary study for CCCERA's unrepresented management employees to comply with the Board's directive to study CCCERA's employees' salaries every three years.

Segal is in the process of completing a termination study for Moraga-Orinda Fire. She noted the Housing Authority will be adopting enhanced benefits for their employees as of October 1, 2008.

Leedom noted both she and Hally will be meeting with two potential candidates for the General Counsel position next week. If a successful candidate is not identified, Leedom will return to the Board with a recommendation for a recruitment firm.

- (b) Outside Professionals' Report - The consultants had nothing further to report.

Leiderman discussed the *Katosh* Case regarding an appellate court decision on "double dipping" on a disability applicant. He noted there have been several cases dealing with permanent incapacity and how far to go back retroactively to begin a retirement benefit.

When asked, Leiderman noted the *Lexin v. Superior Court* status and *amicus* brief will be discussed at the upcoming Attorney's Roundtable

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Page 8

May 28, 2008

- (c) Trustees' Comments - Cabral would like to know the overall expenses of running the retirement system, including Administrative, investment and legal costs. Staff noted the CAFR included this financial information and will be on the agenda in June. Koehler will convert the information to basis points for the Board's review.

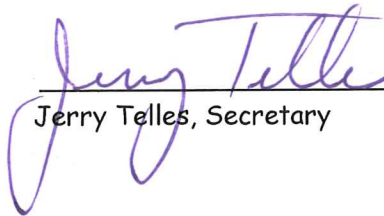
Pollacek - discussed the recent article on travel from a San Jose newspaper, noting the importance of documentation on expense reports. He complimented staff on the explanation in CCCERA's newsletter, FYI, on "Contribution Rates Going Up and Down . . . at the Same Time".

Hast - noted copies of the certificate for the SACRS Ethics presentation that is required for trustees every two years should be kept as a part of the Retirement Office records.

He also reminded all Board members to provide reports for any conferences attended.



Brian Hast, Chairman



Jerry Telles, Secretary