

**ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM  
BOARD OF RETIREMENT  
2223 E. WELLINGTON AVENUE, SUITE 100  
SANTA ANA, CALIFORNIA**

**INVESTMENT MANAGER MONITORING  
SUBCOMMITTEE MEETING**

**May 4, 2017  
9:00 A.M.**

**MINUTES**

The Chair called the meeting to order at 9:02 a.m. and read the opening statement into the record. Attendance was as follows:

Present: Frank Eley, Chair; Charles Packard, Vice Chair; Russell Baldwin and Shawn Dewane

Also present: Steve Delaney, Chief Executive Officer; Shanta Chary, Director of Investment Operations; David Beeson, Investment Officer; Adam Cheng, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Anthony Beltran, Visual Technician; and Julius Cuaresma, Recording Secretary

**A. INDIVIDUAL MANAGER PRESENTATIONS**

Mr. Beeson introduced William Blair, one of four emerging market equity strategies that OCERS is invested in. He discussed William Blair's growth investment style and how each of the other three emerging market equity managers stylistically complement each other. Since May 2006, William Blair has managed assets on behalf of OCERS; the current net asset value is \$307.5 million as of March 31, 2017.

Mr. Beeson described William Blair's relative 2016 underperformance compared to the MSCI Emerging Markets (EM) index. He cited the manager's growth bias as a headwind in a market that relatively favored value stocks over high-quality growth companies.

Ms. Chary observed the variance, tracking error, and inefficiency in emerging markets. She described how style factors go in-and-out of favor, citing the ideal situation but unlikely scenario where a manager outperforms in every market environment. She reported on the William Blair's tendency to be benchmark agnostic, while noting the pros and cons of such an agnostic investment style. She described the attractiveness of the manager's portfolio as well as the overall cheapness of the emerging markets relative to the U.S. markets.

Mr. Dewane and Ms. Chary discussed the role of William Blair in OCERS' portfolio, as well as the role of active versus passive investing in the emerging markets.

Mr. Dewane, Ms. Chary, and Mr. Beeson discussed the time-periods of growth's relative outperformance and underperformance to value within emerging markets.

Mr. Eley observed: 1. the rationale for investing in emerging market equities, specifically, the potential upside; 2. the rationale for its size within a portfolio, specifically, the potential downside; and 3. the difficulty in market timing.

Mr. Beeson discussed William Blair's compliance issues related to their mutual funds and noted that it is not related to OCERS' investment.

## **WILLIAM BLAIR**

***Presentation by Todd McClone, CFA, Casey Preyss, CFA, & Robert Duwa, CFA***

### **The key highlights of the presentation were:**

Firm update: William Blair manages approximately \$67.9 billion (institutional assets represent 90%). The manager is 100% active employee owned. There are nine portfolio managers, supported by twenty fundamental analysts within the global equity investment team. These investment employees have long tenures at William Blair, at 14 years, and 10 years, respectively. William Blair employs a partnership model that also includes analysts.

Market Overview/Outlook for 2017: The manager observed that their portfolio is cheap relative to the market, as a number of their portfolio companies are trading at the same or cheaper levels than other companies who have worse forward earnings expectations, as well as other poor forward-looking metrics. The manager described some relative sector and country weightings, including overweight technology and underweight South Korea. The manager explained that overall, William Blair tends to be structurally underweight South Korea, as there is a relative absence of high-quality growth companies. This speaks to the manager's tendency to be benchmark agnostic, as South Korea is an overweight country in the emerging market index; the manager explained that many of these companies are old economy, i.e., shipbuilding.

Portfolio Strategy: William Blair invests in high-quality growth companies that tend to be leaders in their industry. Such companies benefit from consistent earnings growth – and though these targeted companies are growing fast, these companies are still re-investing in themselves to achieve organic growth.

Performance: The manager reported their recent performance, including their 2016 underperformance of 2.2% net versus the benchmark MSCI EM IMI index's return of 9.9%. The manager explained that William Blair focuses on quality companies, so they naturally are underweight cyclicals, which outperformed in 2016. The manager observed that just one quarter into 2017, William Blair has clawed back some outperformance, with a return of 13.5% versus the benchmark's return of 11.7%. This outperformance has been driven from a rotation out of low valuation stocks into quality companies with strong earnings trends and favorable price momentum.

Mr. Duwa discussed the SEC Wells notice regarding their \$1.25 million payment error, including interest, and the consequent \$4.5 million penalty. He explained that the payment error had no impact on their shareholder's net asset value as all shareholders paid and received the correct price.

Mr. Eley asked for further details regarding their payment error.

Mr. Duwa explained that it was a human coding error, and noted that it ironically occurred during their transition to automating the payment process.

Mr. Eley and Mr. Preyss discussed various metrics that the manager tracks in their investment universe, including quality, valuation, momentum, and Etrend (style revision).

Mr. Eley and Mr. McClone discussed China's tightening efforts and its impact on cyclical versus defensive sectors, and possible types of industries and companies that would outperform and underperform.

Mr. McClone commented that high-quality growth companies would outperform in a tightening China environment. He also presented William Blair's portfolio positioning pre- and post- the U.S. election, as well as their positioning in India (specifically as it relates to India's efforts in demonetizing their currency). He indicated that their exposure in India had initially caused some short-term pain, but the portfolio has since benefitted from this exposure.

Mr. Baldwin asked about Brazil and the manager's thoughts on the country's political upheaval and the country's role as an oil producing economy for the emerging markets.

Mr. McClone responded that a meaningful percentage of the rally in Brazil was driven by currency gains. He commented that while the economy and politics have relatively stabilized, Brazil has not returned to their prior boom times. He observed that Brazil is still an indebted country. He summarized that William Blair has not chased expensive Brazilian cyclical names.

Mr. Packard asked for the manager's thoughts on Argentina.

Mr. McClone responded, describing the changes that the Argentinian government's economic and finance officials, including ones that are former JP Morgan economists and bankers, are doing to revitalize the Argentinian economy, namely deregulating the economy. He commented that in the near-term, the country is likely to be upgraded from frontier to MSCI emerging market status. He explained Argentina is relatively under-owned and is one of the countries that William Blair is relatively overweight.

Mr. Preyss discussed sector overweight and underweight positioning, particularly the underweight to the energy space. He commented on their cautious positioning in the space, primarily due to oversupply that has resulted from the supply and demand imbalance in the U.S. and in the rest of the world.

Mr. McClone remarked on how the U.S. is now the swing producer of oil and how the sector has been disrupted.

Mr. Preyss remarked on China's energy supply and demands, and discussed China's move towards energy efficiency, which is lowering the aggregate demand of oil.

Mr. McClone and Mr. Packard discussed manager relative outperformance and underperformance, particularly as it relates to economic recoveries and expansionary periods.

Mr. McClone explained that the present market favors valuation and that the worst headwind to William Blair's style is likely an environment the economy is coming out of a recession.

Mr. McClone and Mr. Packard discussed tensions in North and South Korea and the potential impact on the markets, particularly as it relates to China's imports (exports) from (to) those countries.

Mr. Baldwin and Mr. Eley discussed China, its role in the global economy, and its status as an emerging market or as a developed one.

Mr. McClone commented that South Korea perhaps should be one of the first countries to exit its emerging market status and graduate into developed status. He remarked that Taiwan is similar, while observing China is somewhere in between the two countries.

Mr. Steven Weintroski, Mission Viejo, addressed the Committee about the manager's presentation, their risk exposures, and their performance attribution.

***The Committee recessed at 10:35 a.m.***

***The Committee reconvened at 10:46 a.m.***

#### **BEACH POINT CAPITAL**

##### ***Presentation by Scott Klein & John Quintanar***

Mr. Beeson introduced Beach Point Capital, who, as of February 28, 2017, managed \$144.3 million on behalf of OCERS through their fund-of-one structure, Beach Point Capital SCF (single-client fund). This investment is within OCERS' diversified credit asset class. He reported that the manager tends to invest in complex, underfollowed, and middle-market credits, where the manager believes they can leverage their in-house research and legal teams' experience and expertise.

Mr. Eley asked if this underfollowed credit space is an area where opportunities may diminish.

Mr. Beeson responded that is always a concern, but OCERS has afforded the manager the flexibility to dynamically shift their exposures to where opportunities present themselves as well as the ability to short for hedging and alpha purposes.

Mr. Packard asked about the manager's leverage levels.

Mr. Beeson responded that the manager does not use much leverage. As of February 28, 2017, Beach Point Capital's portfolio was 92% gross long and 14% gross short.

#### **The key highlights of the presentation were:**

Firm update: Beach Point Capital manages approximately \$12 billion: \$8.5 billion in opportunistic credit, \$2.2 billion in high yield loans and bonds, and \$1.3 billion distressed securitized and special situation investments. The manager has experienced zero turnover at the portfolio manager or CIO level.

Market Overview/Outlook for 2017: Beach Point described the current credit environment as benign. The manager acknowledged that they are not sure of the direction rates will go, but observed that there is more room to go up, than down. The manager reported that a number of ETFs are entering into the market, and suggested that the consequent indiscriminate buying and selling of names should create opportunities for Beach Point.

Portfolio Strategy: Beach Point seeks mispriced securities that have limited downside due to an embedded margin of safety as well as catalyst that will unlock value. Each portfolio position is covered by an analyst, legal, trader, and either the CIO or a portfolio manager. Given the number of potential risks in credit investing, the manager stated that there must be consensus team approval and buy-in for a position to enter into the portfolio. Beach Point has the flexibility to invest across asset classes and up/down the capital structure; that said, the manager noted that the threshold to buy equities is high, and has been historically around the current allocation of 8%.

Performance: Through the end of February 2017, on a net basis, Beach Point has outpaced its benchmark, a 50/50 blend of the Barclay's High Yield index and the Credit Suisse Levered Loan index in 2016, 15.0% versus 13.5%, and since OCERS' initial investment, 7.5% versus 6.4%.

Mr. Eley and Mr. Klein discussed the negative rate environment, including nominal versus real rates.

Mr. Packard and Mr. Klein discussed the investment opportunities that Dodd-Frank Act has created, the possible regulatory changes to Dodd-Frank, and the potential impact those changes could have on Beach Point's opportunity set.

Mr. Klein further noted that the investment opportunities that arose from the Dodd-Frank Act are a limited part of their portfolio.

Mr. Dewane and Mr. Klein discussed the manager's current portfolio, including its current yield and its allocation to distressed, equities, and cash.

Mr. Dewane asked about the manager's hedging strategy.

Mr. Klein responded that they look for asymmetric opportunities where they can buy cheap, low cost of carry insurance that sufficiently hedges the downside.

Mr. Dewane asked if the manager had any exposure to Puerto Rico, specifically the recent bankruptcy situation.

Mr. Klein responded that although they have historically invested in Puerto Rico and recently have analyzed the situation a number of times, they have no material exposure.

Mr. Baldwin and Mr. Klein discussed the energy space, particularly as it relates to renewables and alternative sources of energy.

Mr. Klein further remarked the difficulty in pricing and forecasting oil, noting that as a distressed investor, he finds the energy space unattractive. He stated that when Beach Point invests, they

automatically run scenarios where their investment thesis could go wrong. In such scenarios, Beach Point analyzed that some energy companies might not exist or work economically.

Mr. Baldwin asked about the manager's thoughts and policies regarding Environmental, Social, and Governance (ESG) investing.

Mr. Quintanar responded that Beach Point has no formal investment policy dedicated to ESG, but noted that they do have a number of clients who require Beach Point to invest according to specific investment guidelines that are based upon ESG's policies.

Mr. Baldwin and Mr. Klein discussed the Glass-Steagall Act.

Mr. Eley and Mr. Klein discussed how Beach Point thinks about market corrections.

Mr. Klein added that pessimism naturally permeates their firm. He commented that there seems to be a significant amount of complacency in markets. He described Beach Point's portfolio as defensive, higher quality, shorter duration, and less cyclical. He subscribes to the belief of a market correction every 10 years.

Mr. Eley and Mr. Klein discussed the vast amount of money in the high yield market that does not include shadow banking loans and bonds, direct lending funds, mezzanine, emerging market, and sovereign debt.

Mr. Weintrobski, Mission Viejo, addressed the Committee about the manager's presentation and the subprime auto loan industry.

A **motion** was made by Mr. Baldwin and **seconded** by Mr. Packard to receive and file the manager presentations. The **motion carried unanimously.**

**PUBLIC COMMENTS:**

None

**COMMITTEE MEMBER COMMENTS:**

Mr. Dewane discussed William Blair's standard deviation, alpha, and information ratio relative to the emerging market benchmark.

Mr. Eley discussed the manager's underperformance and outperformance relative to the benchmark in different time periods.

Mr. Dewane and Mr. Eley observed that OCERS should have a larger discussion with the consultants regarding active investing in the emerging markets.

Mr. Dewane observed his preference for active managers.

Ms. Chary discussed the timeliness of this discussion, noting that at the next Investment Committee Meeting, Meketa will have their quarterly portfolio evaluation report.

**CHIEF EXECUTIVE OFFICER/STAFF COMMENTS:**

None

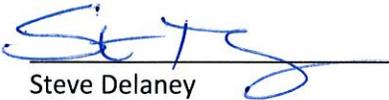
**COUNSEL COMMENTS:**

None

**ADJOURNMENT:**

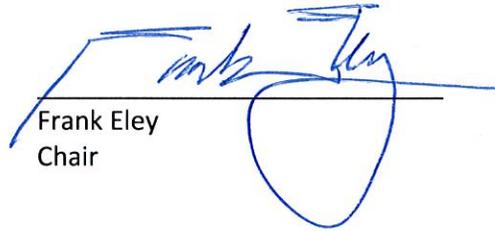
The Chair adjourned the meeting at 11:47 a.m.

Submitted by:



Steve Delaney  
Secretary to the Committee

Approved by:



Frank Eley  
Chair