

July 14, 2010

To: Members of the Board of Retirement

From: Keith Carson - Chair

Subject: Summary of the July 14, 2010 Investment Committee Meeting

The Investment Committee met on Wednesday, July 14, 2010 at 9:04 a.m. The Committee members present were Dale Amaral, Annette Cain-Darnes, Keith Carson, George Dewey, Liz Koppenhaver, Elizabeth Rogers, and Don White. Also present was Alternate Safety member Darryl Walker. Members of the Staff present were Kathy Foster – Assistant Chief Executive Officer, Robert Gaumer – Chief Counsel, J.P. Singh – Chief Financial Officer, Betty Tse – Chief Investment Officer and Catherine Walker – Acting Chief Executive Officer.

ACTION ITEMS

1. Interview of the Three Finalists for ACERA's U.S. Small Cap Value Manager Search and Possible Motion to: i) Recommend One of the Three to the Full Board to Replace Brandywine Global Investment Management (U.S. Small Cap Value), and ii) Terminate Brandywine Global Investment Management (U.S. Small Cap Value) in Accordance with the ACERA General Investment Guidelines, Policies and Procedures
 - At its May meeting, the Board selected Ceredex Value Advisors (Ceredex), Kennedy Capital Management Inc. (Kennedy), Perkins Investment Management (Perkins) and Robeco Investment Management (Robeco) as short-listed candidates for ACERA's U.S. Small Cap Value manager search. After completion of the on-site visits to all four short-listed candidates, Staff and SIS prepared their standardized evaluation matrices with added insights and observations gained from these visits. Both Staff and SIS agreed to 1) eliminate Ceredex from the final candidate list due to the uncertainty surrounding the organization's ownership structure and 2) select Kennedy, Perkins and Robeco as the final candidates for the Committee's interview and consideration.

Following are highlights from each of the three finalists' interviews:

Kennedy

- Kennedy is a Subchapter S corporation located in St. Louis and is 100% employee-owned. The firm is stable with a 30-year history and employs 50 full-time professionals. The Extended Small Cap strategy has exposure in micro cap, small cap and mid cap stocks.
- Representatives from Kennedy provided overview of its firm, investment strategy, process and performance. They stated that Kennedy's large investment team allows for a labor intensive process. The firm systematically screens, identifies and researches compelling micro to mid-cap companies and employs various

“proprietary” research tools including quantitative evaluations and earnings monitors to gauge a company’s financial health.

Perkins

- Perkins is 78% owned by a retail-orientated firm, Janus Capital Group, Inc. (Janus) and is located in Chicago, Illinois. The firm employs 11 senior staff managers and 11 equity research analysts who work in the company’s Chicago office. Back office duties are handled by its parent firm, Janus. The portfolio management team is highly stable with no departures in the past 30 years. The co-PMs of the Perkins Small Cap Value strategy, Bob Perkins (the founder of Perkins) and Todd Perkins (the son of Bob Perkins) collectively have over 50 years of total investment experience.
- Representatives from Perkins presented the ownership structure of the firm, investment strategy, process and performance. They stated that rigorous downside analysis, as well as capital preservation, mean reversion in returns, thorough balance sheet and cashflow analyses are key tenants of Perkins’ investment process. The Perkins Small Cap Value Fund seeks to build a diversified portfolio of high quality, undervalued stocks with favorable risk/return characteristics.

Robeco

- Robeco is a solid institutional investment management firm that is headquartered in Greenbrae, California. Robeco has been a wholly-owned subsidiary of Robeco Group since 2003. Robeco Group is a global investment management company and is wholly-owned by Rabobank Group which is headquartered in the Netherlands.
- Representatives from Robeco reviewed their organization, investment strategy, process and performance. They stated that their value investment philosophy is based on three core principles – value discipline, bottom-up internal research, and risk aversion. The investment process also incorporates quantitative scoring and screening to cull the investable small-cap universe based on three characteristics: attractive valuation, sound business fundamentals, and improving business momentum.
- After discussion, Mr. George Dewey moved, seconded by Ms. Annette Cain-Darnes, to: i) retain Kennedy Capital Management Inc. as ACERA’s new U.S. small cap value equity manager, and ii) terminate Brandywine Global Investment Management (U.S. Small Cap Value) in accordance with the ACERA General Investment Guidelines, Policies and Procedures. The motion passed unanimously.

INFORMATION ITEMS

1. Report on ACERA’s PEARLS investment – venture capital

- Upon completion of all due diligence procedures, in accordance with ACERA’s Private Equity and Alternatives Return Leading Strategy (PEARLS) Policy and the 2010 Investment Plan for ACERA’s PEARLS Portfolio, SIS has officially recommended and Staff has approved a \$12.5 million commitment to Third Rock

Ventures II, L.P., as part of the Venture Capital (VC) allocation in ACERA's PEARLS portfolio, pending completion of legal due diligence and background checks. This commitment would be the first VC allocation in 2010 and the fifth VC investment in ACERA's PEARLS Portfolio.

- A Representative from Third Rock Ventures presented an overview of its organization, investment strategy, process, and relevant updates of its funds to the Committee.

2. Quarterly performance review for the first quarter of 2010 – equities and fixed income

Representatives of SIS presented the following information:

- ACERA's total Fund returned 3.8% in the first quarter of 2010 and was ranked in the upper 35th percentile among public funds greater than \$100 million. The Fund outperformed its Policy Index and the median public fund by 0.1% and 0.2%, respectively. Longer term, the three-year gross return of -0.7% (48th percentile) underperformed its Policy Index by 1.2% and five-year gross return of 4.6% (35th percentile) underperformed its Policy Index by 0.7%. The market value of the total Fund as of 3/31/10 was \$4,817,099,484.00.

3. Quarterly performance review for the first quarter of 2010 – real estate

Representatives from The Townsend Group presented the following information:

- ACERA's real estate portfolio returned 0.8% in the first quarter of 2010, outperforming its benchmark NPI of 0.8% by 0.1%. Longer term, the three-year and five-year gross returns of -9.6% and 1.3% underperformed the benchmark by 5.3% and 2.9%, respectively. As of 3/31/10, the total market value of ACERA's real estate portfolio was about \$254.8 million, approximately 5.3% of ACERA's total Fund.

4. Letter from Bivium Capital Partners, LLC dated June 14, 2010 regarding its organizational changes

- In a letter dated June 14, 2010 to ACERA, Bivium stated that Les Hollis (CEO of Bivium) and Nancy Hollis (Managing Director and Director of Research of Bivium) will be leaving their roles at Bivium effective June 30th, 2010 due to extenuating personal circumstances. Lawrence Bancroft, President and Chief Investment Strategist of Bivium, will assume an additional role as the firm's CEO. Margaret Jadallah, Senior Vice President of the firm, will be promoted to the office of Managing Director where she will be fulfilling the role of Director of Research. As a result, Bivium has been placed on ACERA's Watchlist effective June 17, 2010 in accordance with Section XIX (Watchlist) (C) of the ACERA General Investment Guidelines, Policies and Procedures.
- To assess the extent of the impact of the organizational changes on Bivium, Staff and SIS conducted a joint on-site visit to the said manager at its San Francisco offices on June 28, 2010. Staff and SIS have concerns over the departure of Les and Nancy Hollis as they were two of the three founders of Bivium and will continue to rigorously monitor Bivium

to determine if there is any deterioration in its performance, style integrity, organizational stability, compliance, and client service. Staff will report any further material changes associated with the account and recommend potential actions needed, if warranted.

5. Oral status report on ACERA's International Small Cap Equity manager search

- Staff and SIS have received the RFP responses from all eight candidates for ACERA's International Small Cap Equity manager search and are in the process of evaluating the RFP responses. According to the search timeline, the motion to adopt the short-listed candidates for the on-site visits should be discussed at the July 2010 Investment Committee meeting (ICM). However, to complete the U.S. Small Cap Value Equity manager search, the PEARLS manager search, and the review of ACERA's DB Program, and after consulting with SIS, Staff has tentatively postponed this motion item to the September 2010 ICM.

RECOMMENDATION

- The Committee recommends, and I move, that the Board to: i) retain Kennedy Capital Management Inc. as ACERA's new U.S. Small Cap Value Equity manager; and ii) terminate Brandywine Global Investment Management (U.S. Small Cap Value) in accordance with the ACERA General Investment Guidelines, Policies and Procedures.

FUTURE DISCUSSION ITEMS

Please refer to the updated Investment Committee Workplan for Year 2010 for future discussion items.

TRUSTEE/PUBLIC INPUT

None

ESTABLISHMENT OF NEXT MEETING DATE

August 11, 9:00 a.m.

ADJOURNMENT

The meeting adjourned at 1:25 p.m.