KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

PRUDENT INVESTMENT • QUALITY SERVICE

July 23, 2020

Members, Board of Retirement
Employee Bargaining Units
Requesting News Media
Other Interested Parties

Subject: Meeting of the Kern County Employees' Retirement Association Investment Committee

Ladies and Gentlemen:

A meeting of the Kern County Employees' Retirement Association Investment Committee will be held on Wednesday, July 29, 2020 at 10:30 a.m. via teleconference, pursuant to Executive Order N-25-20, issued by Governor Newsom on March 12, 2020, Executive Order N-29-20, issued by Governor Newsom on March 17, 2020, and Executive Order N-35-20, issued by Governor Newsom on March 21, 2020. Items of business will be limited to the matters shown on the attached agenda.

If you wish to listen to the teleconference meeting, please dial (888) 788-0099 or (877) 853-5247 U.S. Toll-free (Meeting ID 289-998-6429), or see www.kcera.org for instructions. If you have any questions or require additional service, please contact KCERA at (661) 381-7700, option 0.

Sincerely,

Dominic D. Brown
Executive Director

Attachment

AGENDA:

All agenda item supporting documentation is available for public review on KCERA's website at www.kcera.org following the posting of the agenda. Any supporting documentation that relates to an agenda item for an open session of any regular meeting that is distributed after the agenda is posted and prior to the meeting will also be available for review at the same location.

AMERICANS WITH DISABILITIES ACT
(Government Code §54953.2)

Disabled individuals who need special assistance to listen to and/or participate in the teleconference meeting of the Board of Retirement may request assistance by calling (661) 381-7700, option 0, or sending an email to memberservices@kcera.org. Every effort will be made to reasonably accommodate individuals with disabilities by making meeting materials and access available in alternative formats. Requests for assistance should be made at least two (2) days in advance of a meeting whenever possible.

Roll Call

1. Discussion and appropriate action on midstream energy RFP and recommendation presented by Scott Whalen, CFA, Verus, Chief Investment Officer Daryn Miller, CFA, and Retirement Investment Officer Brian Long, CFA, – RECOMMEND THE FOLLOWING TO THE BOARD OF RETIREMENT: SELECT BLACKSTONE AND PIMCO AS MIDSTREAM ENERGY INVESTMENT MANAGERS; WAIVE ON-SITE DUE DILIGENCE REQUIREMENT IN THE IPS; AND APPROVE INVESTMENT IN MIDSTREAM ENERGY

2. Discussion and appropriate action on private market fund recommendation presented by Andrea Auerbach, Kelly Jensen and Anelise Hohl, Cambridge Associates[1], Chief Investment Officer Daryn Miller, CFA, and Retirement Investment Officer Brian Long, CFA – RECOMMEND THE FOLLOWING TO THE BOARD OF RETIREMENT: APPROVE $30MM COMMITMENT TO COVENANT CAPITAL PARTNERS; AUTHORIZE EXECUTIVE DIRECTOR TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW

1 Written materials and investment recommendations from the consultants, fund managers and KCERA investment staff relating to alternative investments are exempt from public disclosure pursuant to California Government Code §6254.26, §6255, and §54957.5.

3. Public Comments:

   This portion of the meeting is reserved for persons to address the Committee on any matter not on this agenda but under the jurisdiction of the Committee. The public is provided the opportunity to comment on agenda items at the time those agenda items are discussed by the Committee. Committee members may respond briefly to statements made or questions posed. They may ask a question for clarification and, through the Chair, make a referral to staff for factual information or request staff to report back to the Committee at a later meeting. Speakers are limited to two minutes. Please state your name for the record prior to making a presentation.

4. Committee Member Announcements or Reports:

   On their own initiative, Committee members may make a brief announcement or a brief report on their own activities.

5. Adjournment

KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Memorandum from the
Office of the Chief Investment Officer
Daryn Miller, CFA

Date: July 29, 2020

To: Trustees, Investment Committee

From: Daryn Miller, Chief Investment Officer

Subject: **Blackstone and PIMCO Midstream Recommendations**

RECOMMENDATION

Staff recommends initial investments of $35 million each in the Blackstone Harvest and PIMCO midstream energy strategies, subject to final Board approval and Staff successfully negotiating acceptable terms and conditions. In addition, Staff requests a waiver to the Investment Policy Statement, as outlined below in the COVID-19 section. If approved, the two midstream strategies will be part of the Plan's midstream energy allocation.

MIDSTREAM ALLOCATION

During the April 1, 2020 Board meeting, the Board approved a long-term strategic asset allocation which includes a 5% allocation to midstream energy. As a reminder, the asset allocation also includes a 5% capital efficiency program, with the largest reductions in core fixed income and cash. Midstream was included due to attractive valuations and yields, and overall attractive total return potential. Staff's recommendation, if approved, would build an initial approximately 1.5% exposure to midstream.

PROCESS

Following the Board's April 1st approval of midstream energy in the long-term strategic asset allocation, Staff coordinated with Verus to determine the best course of action to proceed. Given Staff's desire for midstream energy exposure to include both debt and equity, Verus was not in a position to provide a preferred list of investment managers. As such, Staff decided to issue a Request for Proposal (RFP).

On April 10th, Staff issued the Request for Proposal for Public Market Midstream Energy Investment Strategy. The deadline for submissions was May 1, 2020. Staff received 10 proposals. The RFP included a 26 question questionnaire, and requests for marketing presentation, GIPS compliant monthly returns (gross and net of fees), and Form ADV. The RFP was written so that investment managers could provide proposals that spanned the public market midstream capital structure, i.e. strategy mandates that included midstream equity and debt, exclusively or inclusively.

RFP Review

Between May 1st and May 21st the Plan's Investment Team (Daryn Miller, CIO and Brian Long, Investment Officer) evaluated the 10 RFP proposals, and moved 8 of the 10 to the next phase of the evaluation process.

Video Conference call 1

During the week of May 25th, the Investment Team held approximately 1.5-hour video conference meetings with each of the 8 firms. The key investment professionals, as well as analysts and marketing professionals from the firms, participated in the meetings. The agenda for the meetings included the following topics for discussion:

1) bios and experience of the investment team
2) opportunity set and current investment landscape in midstream energy
3) investment process
4) model portfolios

Following the video conference meetings, the Investment Team reevaluated scoring, and selected the top 5 firms for the next round of diligence.

Video Conference call 2

During the week of June 15th, the Investment Team held another round of 1.5-hour video conference meetings, this time with the top 5 firms. The agenda for the meetings included the following topics for discussion:

1) performance and attribution
2) model portfolios
3) financial modeling
4) production modeling, and basin analysis and views

Following the second round of video conference meetings, the Investment Team again reevaluated scoring and selected the top 2 firms.

Verus Due Diligence

At this phase Staff requested that Verus perform due diligence on the top 2 firms—Blackstone Harvest and PIMCO. Verus coordinated with the 2 firms, requesting information and performing their own due diligence.

COVID-19: POLICY WAIVER REQUESTED

Given the global pandemic, on-site due diligence, which is commonly performed, was not performed as part of this manager search. As context, at this time, more organizations and investment consultants are adapting their due diligence process, and are moving away from on-site due diligence in favor of video conference due diligence meetings.

The KCERA Investment Policy Statement (IPS) states the following:

> "**Manager Search Process**
> …
> Every manager that the Chief Investment Officer and Investment Consultant recommend to the Board must have undergone on-site due diligence not more than one year prior to the recommendation to the Investment Committee. On-site due diligence is to be conducted by the Investment Consultant." *IPS Page 14*

The Plan's general investment consultant Verus, was last physically on-site with Blackstone on 8/28/2019 and with PIMCO on 4/2/2019. With the last PIMCO on-site visit more than one year ago, Staff is requesting a waiver to the IPS policy based on the following, 1) both Staff and Verus performed separate and independent due diligence processes on the firm, 2) PIMCO is a very large investment management firm, is well known, and an institutional quality organization, 3) Verus performed on-site due diligence with PIMCO ~16 months ago, and 4) PIMCO is an existing manager for the Plan, managing 4 different mandates, and both Staff and Verus know the firm well.

BLACKSTONE HARVEST

Harvest was formed in 2005, and in 2017 was acquired by Blackstone. Harvest remains an independent business unit within Blackstone. Since Harvest's founding, the firm has focused exclusively on managing public market midstream energy portfolios.

Blackstone AUM is approximately $538 billion with Harvest AUM of approximately $6.8 billion—the latter in dedicated public market midstream energy investments.

Eric Conklin is the portfolio manager for the strategy, and is supported by a team of nine investment professionals. The team has an emphasis toward the highest quality assets, and tends to build portfolios with a higher quality bias that have historically produced strong returns at lower levels of risk.

The strategy pursues a bottom-up, fundamental research process, and relies on deep industry expertise, modeling, contacts, and analysis. The investment team sees the midstream energy space as misunderstood and mispriced, and in the context of today's low return environment, sees a compelling opportunity with high current income and the opportunity for asset valuations to re-rate higher.

Terms: the fee structure will utilize tiered pricing, with the management fee based on the KCERA assets that are managed by Blackstone in the midstream energy mandate. The annual management fee will be approximately 75bps. There is no performance fee associated with the mandate. In addition, given that the mandate will be run in a separately managed account, there will be no fund operating expense.

Verus has provided additional details regarding the firm, team, and strategy in their supporting memo.

PIMCO

KCERA has a long-standing relationship with PIMCO, and the Plan currently has 4 mandates with PIMCO--StocksPLUS, Core Plus, EM Debt (passive), and PIMCO Commodity Alpha Fund. The Plan's CIO has interacted with Greg Sharenow (one of the 3 lead portfolio managers for the midstream mandate) over the past approximately 6 years, most recently as a result of the Plan's investment in the PIMCO Commodity Alpha Fund, where Greg is part of the investment team.

PIMCO is a subsidiary of Allianz Asset Management, and PIMCO AUM is approximately $1.8 trillion. The firm manages approximately $1.3 billion in midstream energy related strategies.

The portfolio management team consists of three portfolio managers—John Devir, Mark Kiesel, and Greg Sharenow. The portfolio managers are supported by dedicated analysts, as well as the firm's deep bench of equity and credit analysts.

The team begins with a top/down macro perspective, then takes a total capital structure approach, leveraging bottom-up, fundamental credit and equity research.

Terms: the fee structure will utilize tiered pricing, with the management fee based on total KCERA assets that are managed by PIMCO, as well as the mix between equity and debt. We estimate the annual management fee to be approximately 45bps. There is no performance fee associated with the mandate. In addition, given that the mandate will be run in a separately managed account, there will be no fund operating expense.

Verus has provided additional details regarding the firm, team, and strategy in their supporting memo.

CONCLUSION

Following the Investment Team's due diligence process, and with the concurrence of Verus, we recommend the Plan allocate $35MM each to Blackstone Harvest and PIMCO midstream energy strategies.

Memorandum

To: Investment Committee, Kern County Employees' Retirement Association

Cc: Daryn Miller, CFA Chief Investment Officer

From: Scott J. Whalen, CFA, CAIA, Executive Managing Director | Senior Consultant
Stuart Odell, Managing Director | Senior Consultant

Date: July 29, 2020

RE: Midstream energy manager due diligence

Executive Summary

KCERA Staff is proposing to hire two complementary managers to fulfill a long-only US midstream energy investment mandate as part of the Plan's approved strategic asset allocation (5% of the total investment portfolio). Further, Staff is proposing to split the mandate equally between the following two managers.

- Blackstone's Harvest midstream energy team
- PIMCO's MLP and energy infrastructure team

As part of our analysis, we reviewed manager-provided investment materials and conducted due diligence with both firms via video conference. We focused our evaluation on their respective investment teams, investment philosophies and strategies, and implementation and portfolio construction processes. We did not perform detailed operational, compliance, or other back-office related due diligence during this review. Both firms are well-established, institutional asset management organizations, whose operations and compliance infrastructure and portfolio risk management processes have been vetted by Verus for other products and strategies over many years.

Based on our review of the materials and our virtual due diligence visits, Verus is supportive of staff's manager recommendations. Both teams have well-defined and tested investment processes implemented by experienced investment professionals. The investment philosophies and strategies of both teams are complementary, with PIMCO utilizing their fixed income asset management processes and Harvest utilizing their fundamental, bottom-up equity approach. Further, PIMCO's ability to incorporate fixed income into a portion of their portfolio increases the opportunity set and should provide additional diversification benefit. Both teams have demonstrated performance track records in line with expectations, based on our understanding of their respective investment philosophy and process.

We are supportive of Staff's recommendation. If the recommendation is approved by the Investment Committee, next steps include seeking approval from the full Board, negotiation and document review, account set up, and funding.

Public US Midstream Energy Landscape

Midstream energy companies provide the critical infrastructure linking the supply of commodities, such as crude oil, natural gas, and natural gas liquids to end users and include pipeline operators and other firms involved in the processing, storage, and transport of petroleum products. The index representing the US equity midstream investable opportunity set is the Alerian Midstream Energy Index, and both PIMCO and Harvest use this index as the benchmark for their long-only equity midstream energy portfolios.

Harvest

Harvest Fund Advisors ("Harvest") was formed in November 2005 by Eric Conklin and John Simkiss to focus on managing public market midstream energy portfolios for institutional investors. In October 2017, Harvest was acquired by The Blackstone Group Inc. (together with its affiliates, "Blackstone"). Harvest remains an independent business unit within Blackstone, reporting through Blackstone's credit team but with a separate P&L. The Harvest team remains in its original location in Wayne, PA, separate from other Blackstone teams and operations. While we have not been on-site with the Harvest team specifically, a member of our manager research group has conducted on-site due diligence with Blackstone within the past year.

As of March 31, 2020, Harvest had $6.8B in AUM, all of which is invested in public markets midstream investments. Since the launch of the long-only strategy in 2008, Mr. Conklin has served as lead portfolio manager, overseeing both Harvest's research process and security selection for the strategy. Mr. Conklin has an extensive background in midstream energy. Prior to forming Harvest, Mr. Conklin did midstream equity research at both Credit Suisse and Lehman Brothers and energy banking and M&A at Bank of New York and JP Morgan, respectively. Mr. Conklin's experience in midstream energy has resulted in an extensive network of industry relationships, which is clearly an advantage given the bottom-up, fundamental nature of their investment process. Mr. Conklin noted that some of the investors in his strategy are asset owners/operators within the midstream energy sector with whom he engages directly for strategic advice and information on industry trends.

John Simkiss, also a founding partner of Harvest, has served as Mr. Conklin's primary sounding board and back-up since the launch of the strategy. In addition to Mr. Conklin and Mr. Simkiss, there is a team of eight dedicated investment analysts that cover the names within the midstream investment universe and serve on the Harvest investment committee. Analysts are assigned coverage of individual names on a rotating basis, allowing for coverage redundancy, and also providing the opportunity for analysts to become intimately familiar with the entire investable universe over time.

Harvest employs a fundamental bottom up investment philosophy and process by disaggregating individual companies into their underlying asset holdings and then analyzing those assets using proprietary quantitative and qualitative models to identify which midstream companies offer the best short- and long-term investment potential. Harvest's quantitative models assist them in ranking and comparing midstream companies across valuation, cash flow and comparable market multiples, which allows them to apply stress tests to the underlying portfolio assets and company valuations. Qualitative assessments on potential investments, as well as final security selection and sizing for inclusion or removal from client portfolios, is determined by Mr. Conklin.

The primary risk/return drivers of midstream energy companies that Harvest incorporates into their models and analysis are liquidity, level of underlying commodity exposure, amount of leverage, asset size/scope, CAPEX requirements, asset quality, management team quality and ESG factors.

Harvest's investable universe consists of approximately 140 public North American energy infrastructure names, consisting of $850 billion combined market cap of common equity. All names are either MLPs, affiliated C-corporations, or energy infrastructure C-corporations with midstream assets.

Harvest's proposed model portfolio consists of 24 securities with an average position size of 4%, a maximum current holding position size of 17.4%, and an overall dividend yield of 13.3%. A more concentrated portfolio approach for this strategy relative to the benchmark seems appropriate given the fundamental research process, deep industry expertise, and access to industry executives, all of which should allow Harvest to develop high conviction in the names included in the portfolio.

Since inception performance has been good, as the strategy has outperformed its benchmark in nearly every full calendar year, often by a wide margin (600 basis points in 2019). Notably, Harvest has achieved this success while incurring less risk than the benchmark.

PIMCO

As a wholly owned subsidiary of Allianz Asset Management with $1.78 trillion in assets under management, PIMCO has a long history of investing in energy and is one of the largest investors in the sector. In 2000, PIMCO launched a dedicated commodity strategy; in 2014, the firm launched a dedicated MLP & energy infrastructure fund; and last year they launched an energy-focused credit mutual fund. The combined assets of these three strategies exceed $13 billion.

PIMCO's MLP and energy infrastructure team manages both debt and equity investments across the entire energy value chain, including midstream. The proposed mandate for KCERA, which will focus on debt and equity midstream investments, would be co-led by the same three lead PM's within PIMCO's energy infrastructure team, i.e., John Devir, Mark Kiesel and Greg Sharenow. Mr. Devir heads the Americas research team for PIMCO and is also the lead research analyst for the energy sector and portfolio manager for MLPs and energy infrastructure. Mr. Sharenow focuses on commodities and real assets and also co-manages the PIMCO Energy and Tactical Credit Opportunities fund. Mark Kiesel, CIO of global credit, and a member of PIMCO's investment committee, also serves as a generalist portfolio manager, as well as the global head of corporate bond portfolio management for PIMCO's investment grade, high yield, bank loan, municipal and insurance business. He also leads credit research and PIMCO's actively managed equity business. The three lead PM's are supported by six dedicated primary energy sector research analysts. In addition to the dedicated resources listed above, the energy infrastructure team receives additional contributions from other related sectors within PIMCO, including commodities, chemicals, utilities, and freight. The team is also able to leverage firm resources more broadly within credit and credit research, commodities, equities and legal.

PIMCO will utilize the same top-down-macro / bottom-up-fundamental equity and credit research process for the KCERA mandate that they use across all PIMCO investment strategies. Verus is very familiar with PIMCO's investment philosophy, as we regularly evaluate and monitor many PIMCO strategies across our client base. The last time on-site due diligence was conducted in person by our manager research team was in early 2019. We recently conducted a due diligence visit in April, but because of the Covid outbreak, that visit was conducted via video conference.

PIMCO considers their investable opportunity set within midstream energy to include the 48 equity securities that make up the Alerian Midstream Energy Index, 22 investment grade midstream debt issuers, and 32 high yield midstream debt issuers. Based on their proposed model portfolio, about half would come from equity with the other half comprised of investment grade and high yield debt. The proposed model portfolio consists of 57 securities in total across 24 different companies with an average equity allocation of 2.4% and maximum equity position size of 4.5%. The current yield of the equity component of the proposed model portfolio is 13.6%, investment grade is 5.9%, and high yield is 9.4%, providing a combined portfolio yield of 10.2% with a duration of 2.8 years.

Investment performance for the proposed KCERA portfolio was evaluated based on the MLP energy infrastructure composite provided in the scope of services request response to KCERA. The composite has outperformed its benchmark every year since inception in 2015 with annual outperformance ranging between 100 bps and 350 bps.

Recommendation and Next Steps

Based on our evaluation, we are supportive of Staff's recommendation to utilize both managers to fulfill KCERA's strategic allocation to public US midstream energy opportunities and to split the mandate evenly between them. Based on our review, we believe the two managers are likely to be complimentary given their different investment styles and approaches to portfolio construction. PIMCO's portfolio can incorporate fixed income in lieu of equities whereas, Harvest invests exclusively in equities, but also has the ability to invest in a broader set of equities not contained within the midstream equity index benchmark.

If the Investment Committee approves our recommendation, next steps include seeking approval from the full Board, negotiation and document review, account set up, and funding.

ALTERNATIVE INVESTMENTS RECORDS

EXEMPT FROM PUBLIC DISCLOSURE

(CA Gov. Code §6254.26)
(CA Gov. Code §6255)
(CA Gov. Code §54957.5)

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