

Executive Team

Dominic D. Brown, CPA, CFE
Chief Executive Officer

Daryn Miller, CFA
Chief Investment Officer

Jennifer Zahry, JD
Chief Legal Officer

Matthew Henry, CFE
Chief Operations Officer



Board of Retirement

Tyler Whitezell, Chair
Phil Franey, Vice-Chair
Jeanine Adams
David Couch
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Joseph D. Hughes
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Chase Nunneley, Alternate
Robb Seibly, Alternate

October 13, 2023

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, October 18, 2023 at 1:00 p.m. in the KCERA Boardroom, 11125 River Run Boulevard, Bakersfield, California, 93311.

How to Participate: Listen to or View the Board Meeting

To listen to the live audio of the Board meeting, please dial one of the following numbers (for best audio a landline is recommended) and enter ID# 856 2028 4599

- (669) 900-9128; U.S. Toll-free: (888) 788-0099 or (877) 853-5247

To access live audio and video of the Board meeting, please use the following:

- <https://us02web.zoom.us/j/85620284599?pwd=WU52bRjNkk4cUpCMkFUNTZ1cHFaUT09>
- Passcode: 216834

Items of business will be limited to the matters shown on the attached agenda. If you have any questions or require additional service, please contact KCERA at (661) 381-7700 or send an email to administration@kcera.org.

Sincerely,

Dominic D. Brown
Chief Executive Officer

Attachments

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 meeting of the Board of Retirement may request assistance by calling (661) 381-7700 or sending an email to administration@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.

CALL TO ORDER

ROLL CALL (IN PERSON)

AB 2449 REMOTE APPEARANCE(S)

Items 1 and/or 2 withdrawn from agenda if no trustees will have a need to appear via teleconference:

The first two items on the agenda are reserved for trustees who have a need to appear via teleconference due to a "just cause" need or an "emergency circumstance." Trustees who have notified this Committee before agenda-posting will be called upon and will provide a general description of their need to attend via teleconference as allowed by law. Trustees who were not able to notify the Committee in advance of posting and have a need to attend via teleconference will state their notification or request when called upon to do so. All trustees appearing via teleconference will need to disclose any adult person(s) present in the room of their remote location and their relationship to such person(s). Trustees appearing remotely are reminded to keep their camera on throughout the meeting.

1. **JUST CAUSE CIRCUMSTANCE(S):**

- a) The following Trustee(s) have notified the Committee of a "Just Cause" to attend this meeting via teleconference. (See Government Code § 54953).
 - NONE
- b) Call for Trustee(s) who wish to notify the Committee of a "Just Cause" to attend this meeting via teleconference. (See Government Code § 54953).

2. EMERGENCY CIRCUMSTANCE(S):

a) The following Trustee(s) have requested the Committee approve their attendance of this meeting via teleconference due to an “Emergency Circumstance.” (See Government Code § 54953).

- NONE

b) Call for Trustee(s) requesting the Committee approve their attendance of this meeting via teleconference due to an “Emergency Circumstance.” (See Government Code § 54953).

TAKE ACTION ON REQUEST(S) FOR REMOTE APPEARANCE

3. [Discussion and appropriate action on private market fund recommendation](#) presented by Keirsten Lawton, Managing Director, Cambridge Associates¹, and Senior Investment Officer Geoff Nolan – RECOMMEND THE BOARD OF RETIREMENT APPROVE UP TO \$40MM COMMITMENT TO ITE RAIL FUND L.P.; AUTHORIZE CHIEF EXECUTIVE OFFICER TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW

4. [Discussion and appropriate action on termination recommendation for AB Emerging Markets Strategic Core Equity](#) presented by Scott Whalen, CFA, Chief Investment Officer Daryn Miller, CFA, Senior Investment Analyst Jack Bowman, and Investment Analyst II Rafael Jimenez – RECOMMEND THE BOARD OF RETIREMENT TERMINATE AB EMERGING MARKET STRATEGIC CORE EQUITY FUND

PUBLIC COMMENTS

5. The public is provided the opportunity to comment on agenda items at the time those agenda items are discussed by the Committee. 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. 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.

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 § 7928.710, § 7922.000, and §54957.5.

REFERRALS TO STAFF, ANNOUNCEMENTS OR REPORTS

6. On their own initiative, Committee members may make a brief announcement, refer matters to staff, subject to KCERA's rules and procedures, or make a brief report on their own activities.

7. Adjournment



ALTERNATIVE INVESTMENTS RECORDS

EXEMPT FROM PUBLIC DISCLOSURE

(CA Gov. Code §7928.710)

(CA Gov. Code §7922.000)

(CA Gov. Code §54957.5)

DO NOT REPRODUCE

DO NOT DISTRIBUTE



Date: October 18, 2023

To: Trustees, Investment Committee

From: Daryn Miller, CFA, Chief Investment Officer
Jack Bowman, Senior Investment Analyst
Rafael A. Jimenez, Investment Analyst II

Subject: **Emerging Markets Manager Termination**

RECOMMENDATION

Staff recommends the termination of the Alliance Bernstein Emerging Markets Strategic Core (“Strategy”) mandate. Staff has arrived at this recommendation through thorough analysis and diligence of the Strategy’s relative performance, expected drivers of excess return, and ability to produce investment results that are repeatable, understandable, and consistent with expectations.

BACKGROUND

Alliance Bernstein Emerging Markets Strategic Core: The Alliance Bernstein Emerging Markets Strategic Core Strategy forms a part of the Plan’s Emerging Market Equity allocation within the broader Global Equity portfolio. As of the end of Q3 2023, the market value of the Strategy was valued at \$53.1M. The Strategy represents 24.5% of the Plan’s allocation to Emerging Markets Equity, 3.2% of the Plan’s allocation to Global Equity, and 1.0% of the total Plan assets as of the end of Q3 2023.

The Strategy’s performance was assessed from inception of KCERA’s investment (December 2016) in addition to a longer time period dating back to inception of the Strategy (July 2012) in order to better analyze performance over different market cycles and environments. The Strategy is benchmarked to the MSCI Emerging Markets Index (Net Dividend).

Investment Philosophy & Process: The Strategy is structured to earn a premium above the benchmark over a market cycle through the combination of downside protection and capturing most of the upside in rising markets. This is explicitly expressed through the Strategy’s 90% upside-market capture ratio / 70% downside-market capture ratio objective. In principle, achieving this asymmetric return profile should produce attractive relative returns as capturing less of the market’s downside permits investment returns to compound to a higher rate of return.

The portfolio management team seeks to accomplish its investment philosophy through investing in high-quality, stable companies at the right price; the team commonly refers to these attributes as “Quality”, “Stability”, and “Price” (“QSP”). Quality aims to capitalize on the empirical evidence that companies with quality metrics, such as high profitability, have shown that profitability can be maintained for longer than mean reversion would suggest. Stability can be translated to the *low volatility premium* or the belief that less crowded, lower beta stocks will outperform the Capital Asset Pricing Model based on their betas. Price is comparable to value and allows the team to invest in companies with a higher margin of safety.

Performance: The Strategy has delivered an annualized net-of-fee return of 3.63% from KCERA's investment inception through the end of Q3 2023, resulting in -0.34% excess return relative to the MSCI EM Index over the same period. The Strategy has delivered an annualized net-of-fee return of 4.18% from Strategy inception through the end of Q3 2023 or 1.57% of excess return over the benchmark.

The Strategy has successfully added value in periods where the team was able to achieve its stated 90% upside capture / 70% downside capture ratio, unfortunately this has not been the case on a consistent basis. Staff has calculated the Strategy's capture ratios on an annual basis based on monthly returns of the composite (gross-of-fees for comparability) and the index. Staff has determined that on an annual basis, the Strategy was able to concurrently realize its target capture ratio of 1.286 (i.e., 90% upside / 70% downside) in three calendar years since Strategy inception; two of the years were prior to KCERA's investment. It should be noted that the Strategy has been effective at providing downside protection and has captured less than 70% of the broader market's downside in four calendar years since Strategy inception. However, the downside protection alone has not been enough to compensate for the overall underperformance of the Strategy. Since KCERA's investment inception, the Strategy has achieved an 85% upside capture ratio and an 80% downside capture ratio.

Staff has also examined the explanatory power of QSP through the factor's coefficient of determination (R^2) since Strategy inception in July 2012. In order to derive R^2 , staff examined the correlation of the Strategy's excess return with the performance of the QSP factors. QSP factors were modeled through the returns of the *MSCI Emerging Markets Factor Mix "A"* Index, an equal weighted combination of the MSCI Quality, Minimum Volatility, and Value Weighted indices. Staff determined that although in certain years, the explanatory power of QSP to the Strategy's excess return was significant, the magnitude of R^2 is not consistent between different time periods. The explanatory power of the factors since inception is approximately 29%. The result of staff's analysis is that over 70% of the Strategy's relative performance can be attributed to either, 1. idiosyncratic stock selection or 2. other factors.

REINVESTMENT

Staff believes that the inefficiencies inherent in Emerging Markets Equity make the asset class attractive for active management. Staff will undertake a search to replace the Strategy with another active investment manager. The manager has not yet been determined. In the interim, cash from the recommended termination will be invested in the passive *Mellon Emerging Markets Stock Index Fund*.

CONCLUSION

The decision to terminate an existing investment manager is never easy. It is usually the case that the decision is not formulaic but includes both art and science. Staff has determined that while the team at Alliance Bernstein has developed and articulated a clear investment philosophy, the team has not been able to capitalize on their proposition in a consistent manner resulting in the Strategy's underperformance. Furthermore, the inconsistency leads to investment results that are both less repeatable and understandable for the investor. Consequently, Staff has determined that termination is appropriate.

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 and Senior Consultant
Date: October 18th, 2023
RE: AB Emerging Markets Strategic Core Equity

Executive Summary

KCERA Investment Staff recently conducted a review of the AB Emerging Markets Strategic Core Equity fund ("the fund"). This review follows an extended period of lower-than-expected performance and was conducted to ensure KCERA's Emerging Market Equity allocation fulfills its role in the overall investment portfolio. Following a thorough evaluation Staff is recommending termination at this time, based on concerns the strategy will not meet performance expectations going forward. Staff is further recommending that upon termination the assets held in the strategy be moved to the Mellon Emerging Markets Stocks Index Fund as a passive holding place until a suitable replacement can be found.

Verus supports Staff's recommendation.

Strategy

The Emerging Markets Strategy Core Equity fund is built to capitalize on a series of pricing anomalies AB has identified and refers to as quality, stability, and price ("QSP"). Quality aims to capitalize on the empirical evidence that companies with favorable quality metrics (e.g., high profitability) can maintain those metrics longer than the market expects. Stability essentially refers to the "low volatility premium". Because many investors are drawn to stocks with abnormally high returns, they overestimate the chance of future success of these stocks and are also overconfident in their ability to identify future winners. This leads the fund to focus on less followed, lower-beta stocks, which tend to outperform relative to market expectations. Finally, Price is essentially AB's version of value, and they argue price discipline allows the fund to avoid crowded trades and invest in companies with a higher margin of safety.

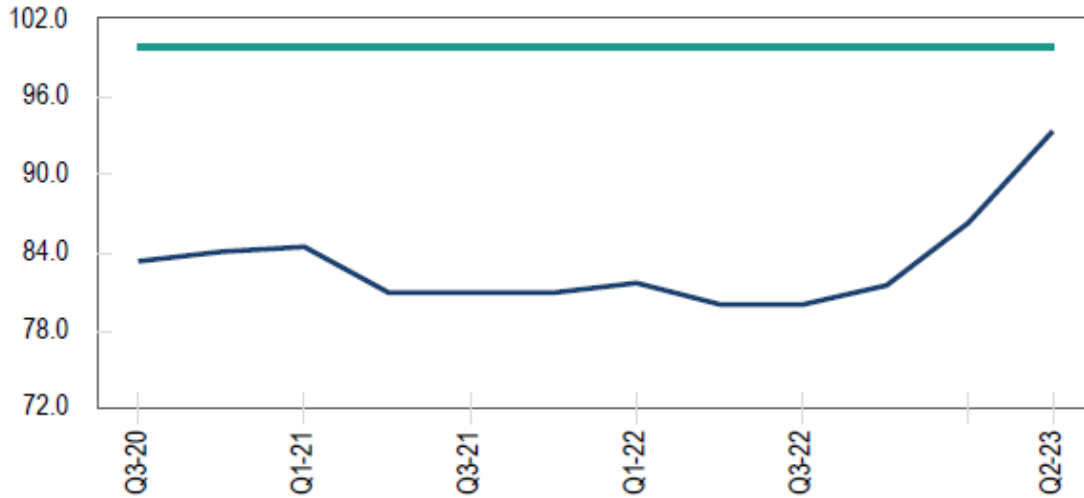
AB seeks to capture these QSP attributes through their use of quant models and proprietary bottom-up, fundamental research. They believe the fundamental research captures idiosyncratic drivers, which add valuable context to the quantitative QSP profile and supports the decision-making process.

Performance

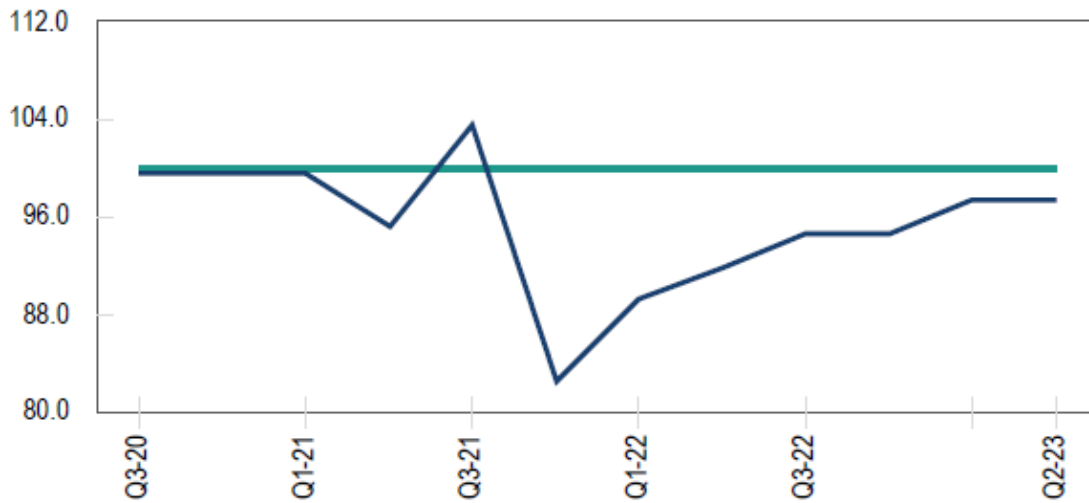
KCERA initiated its position in the fund in 2016. The original thought behind the investment was that AB offered lower volatility and downside protection in an historically high-volatility asset class. A key component of AB's investment philosophy is that downside protection will provide a larger base from which to recover during up markets, leading to higher long-term returns. AB targets a downside capture ratio of 70%, which means that on average, the fund will only fall 70% as far as the benchmark as markets sell off. Conversely, AB targets a 90% upside capture

ratio, meaning the fund will return 90% of the benchmark return when markets are rising. Since inception, AB has not met these objectives, capturing more of the downside and less of the upside than anticipated. And while the fund has shown considerably less volatility than the benchmark and the median peer in a representative peer universe, the fund has also underperformed the benchmark and median peer over most time periods. Recent upside/downside capture and longer-term relative performance is shown in the following charts.

Rolling 3 Years Up Capture

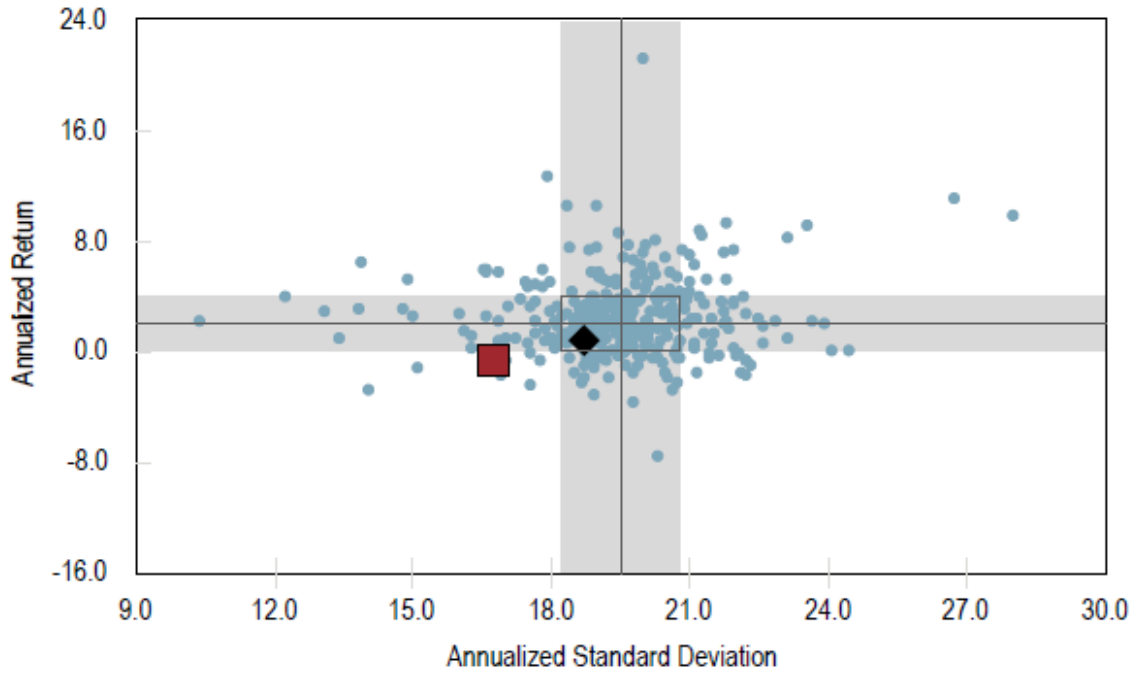


Rolling 3 Years Down Capture



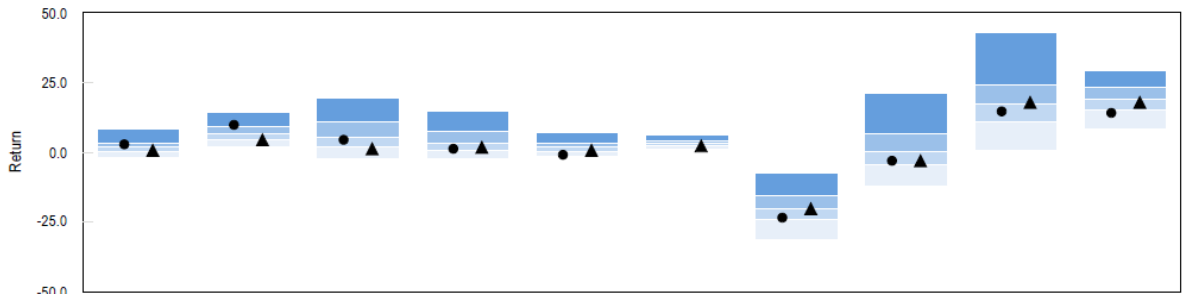
— AB Emerging Markets Strategic Core Equity
 — MSCI Emerging Markets (Net)

5 Years Annualized Return vs. Annualized Standard Deviation



	Return	Standard Deviation
■ AB Emerging Markets Strategic Core Equity	-0.61	16.73
◆ MSCI Emerging Markets (Net)	0.93	18.70
— Median	2.19	19.50

AB Emerging Markets Strategic Core Equity vs. eV Emg Mkts Equity



	3 Mo	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	2022	2021	2020	2019
● AB Emerging Markets Strategic Core Equity	3.48 (32)	10.30 (21)	5.01 (58)	1.60 (73)	-0.61 (93)	-	-23.23 (73)	-2.90 (70)	15.23 (64)	14.75 (81)
▲ MSCI Emerging Markets (Net)	0.90 (72)	4.89 (77)	1.75 (79)	2.32 (65)	0.93 (71)	2.95 (69)	-20.09 (51)	-2.54 (68)	18.31 (47)	18.42 (57)
5th Percentile	8.61	14.71	19.63	15.15	7.48	6.48	-6.79	21.39	43.39	29.73
1st Quartile	3.92	9.59	11.31	8.29	3.81	4.50	-15.22	7.06	24.57	23.50
Median	2.16	7.08	6.11	3.93	2.19	3.58	-20.03	0.58	17.72	19.24
3rd Quartile	0.71	5.01	2.22	1.23	0.74	2.76	-23.87	-4.35	11.53	15.83
95th Percentile	-1.58	2.09	-2.42	-2.11	-1.31	1.48	-31.04	-11.90	1.01	8.46

Verus Position

We believe patience with managers is an important contributor to the long-term success of an investment strategy, and extended periods of underperformance occur with even the best managers. That said, AB's underperformance appears to be attributable to an inability to consistently execute on a key element of their investment philosophy, i.e., upside and downside capture targets, which has led to long-term underperformance relative to both their benchmark and a representative peer group. As such, we concur with Staff's recommendation to terminate at this time.

Past performance is no guarantee of future results. This document is provided for informational purposes only and is directed to institutional clients and eligible institutional counterparties only and is not intended for retail investors. Nothing herein constitutes investment, legal, accounting or tax investment vehicle or any trading strategy. This document may include or imply estimates, outlooks, projections and other "forward-looking statements." No assurance can be given that future results described or implied by any forward-looking information will be achieved. Investing entails risks, including possible loss of principal. Verus – also known as Verus Advisory™.
