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To: MCERA Board of Retirement

From: Callan LLC

The following document contains a draft set of investment beliefs for consideration by the Mendocino County Employees Retirement Association. This is not intended to be a final document. Rather, the content of this proposal is intended as a catalyst for Board discussion of topics key to the formation of a finalized investment philosophy statement for MCERA. Such topics may include, but are not limited to: time horizon, risk, market efficiency and liquidity. The following statement was drafted specifically for MCERA based on our understanding of the Association and its stake holders and following a review of investment philosophy statements adopted by other public defined benefit pension plans.

The purpose of this document is to codify the principles and beliefs of MCERA in designing, implementing and overseeing the investment of the MCERA Pension Plan. It is intended to be a living document, owned and periodically reviewed by the Board, both in its current membership and for future generations of membership. Once finalized, this document should be considered in concert with the Investment Policy Statement and Board Charter.

We expect to modify and update the proposed statement based on discussion at the February 20th Board of Retirement meeting. We expect to present a revised statement to the Board at a future meeting.

Investment Beliefs

Mendocino County Employees Retirement Association is a long-term investor with investments that need to balance the cost and benefits of current and future stake holders, including beneficiaries and tax payers.

Mendocino County's liabilities are long term in nature. The timing and magnitude of future liabilities, as well as the liability's sensitivity to changes in inflation, should influence the Association's asset allocation, risk tolerance, and preference for liquid vs illiquid investments.

Setting asset allocation policy is the most important determinant of return and risk for the Association's investment program. Asset allocation decisions should balance the benefit of long term growth provided by the capital markets with the ability to weather short term drawdowns due to capital market volatility.

The Association's long time horizon is an investment advantage relative to investors with a short-term focus. This long horizon allows the Association to invest through market cycles, invest for the long term, and, when deemed advantageous, invest in strategies which are less liquid.

Over the long term, equity and equity associated investments will offer a risk premium over low risk and risk free assets. Other risk premia exist, which may lead to a strategic overweight, relative to a typical market cap weighted index. Examples of risk premia include Small Companies vs Large Companies, Emerging Economies vs Developed Economies, Credit vs Government Securities, Illiquid vs Liquid assets.

Risk is inherent in investing. Portfolio volatility is best managed through diversification across asset classes, styles, and geographies.

Standard deviation is a useful yet incomplete measure of risk. Other pertinent risk measures include liquidity, complexity, and permanent loss of capital. Being multi-faceted, risk should be viewed through both qualitative and quantitative lenses.

High volatility at the total plan level can impact contribution rates. Negative equity markets, which impact market values, will at times be correlated with slow economic growth, which may impact the ability of the Sponsor to make contributions.

Tactically managing asset allocation in a successful and consistent manner is very difficult. As such, the MCERA Board will focus on strategic asset allocation and will not "time the market."

Strong governance procedures within the Association, within the Association's investment managers, and within portfolio companies will lead to more successful and sustainable results.

Market efficiency is inversely related to an investor's ability to add value over a market index. The level of efficiency with a market varies by asset class. Some asset classes by their nature necessitate active management (private equity and real estate) while others can be implemented passively.

In some asset classes active managers have demonstrated the ability to add value, on average, while in other more efficient asset classes the average active manager has not consistently added value net of fees. The Association will balance the blend between active and passive management based on managers' historic ability to add value in the given asset class as well as the Association's confidence in the ability to identify above average managers.

Fees and the transparency of fees are an important consideration. Costs will be effectively managed.

As a long-term investor, Mendocino County has responsibilities beyond risk and return.

To the extent possible the Association should favor investment processes which support sustainable results, strong governance, and effectively regulated financial markets.