RESOLUTION NO. 83-003

ADMINISTRATION, INVESTMENT AND FISCAL MANAGEMENT BOARD
OF THE
SACRAMENTO CITY EMPLOYEES RETIREMENT SYSTEM

A RESOLUTION ADOPTING INVESTMENT ASSET
INCREMENT REALLOCATION PROCEDURES

February 22, 1983

WHEREAS, it has been the policy of the Board that increments to investment funds, including but not limited to realized gains, dividends and interest, are to be credited to the assets of the System and periodically redistributed to the various asset managers pro rata according to the individual manager's share of assets managed; and

WHEREAS, changes in that policy are recommended by the City Treasurer in his report attached hereto as Attachment A;

NOW, THEREFORE, BE IT RESOLVED that:

1. The recommendations of the City Treasurer, with respect to reallocation of increments to invested assets held by investment managers, are approved.

2. There shall be credited to the asset increments to account of each investment manager all increments to the assets in that account, to be held and invested by the manager pursuant to the agreement between SCERS and the manager.

3. On January 1 and July 1 of each calendar year, the City Treasurer shall determine for the previous six-month period the nature and amount of investment increments credited to each manager's account.

4. After making such determination, the City Treasurer shall redistribute all such increments pro rata to the various asset managers in accordance with the Board's investment diversification policy.

5. Provided, however, that the City Treasurer shall have the discretion as to any or all managers, to submit the matter to the Board for decision with a recommendation for an alternative reallocation procedure which is reasonable under the circumstances.

Ralph W. D'Agostini
Chairman

APPROVED AS TO FORM:

William P. Carnazzo
Deputy City Attorney

ATTEST:

Richard E. Snyder
Secretary to the Board

ATTACHMENT A

CITY OF SACRAMENTO

OFFICE OF THE TREASURER

800 - 10TH STREET SUITE 1

SACRAMENTO, CA 95814
TELEPHONE (916) 449-5318

THOMAS P. FRIERY
TREASURER

Philip A. Barach
XXXXXXXXXXXXXXXX
ASST. TREASURER

January 7, 1983

TO: Administration, Investment and Fiscal Management Board (AI & FM)

FROM: Thomas P. Friery, City Treasurer

SUBJECT: Status Report on Transition of New Equity Manager and Policy Consideration for Allocation of Investment Funds

---

SUMMARY

The transition of the new equity core managers occurred as planned December 31, 1982. The financial data, etc. relative to this transition will be reported in the Financial section of this paper.

As a result of direct questions raised by both Alliance Capital Management and Batterymarch relating to fund allocation the Treasurer, after discussions with System counsel, agreed to let all increments derived from the initial fund allocation to innure and accrue to the benefit of the fund managers and that every six months thereafter the Treasurer will reapportion to all investment classifications the original Board allocation or permit the Board to reconsider their policy as to fund allocation. This immediate action which ultimately requires Board approval, was effected since Batterymarch and Alliance Capital would not have been willing to initiate investment management of the core portfolio without informal assurance from the City Treasurer.

The issues surrounding this action are: (1) the fee income the fund manager will earn for investment management and, (2) a methodology to permit the fund manager to know how much money he has available for reinvestment.

The reason this problem had never surfaced in the past is the fact that the former fund manager never became fully invested. Therefore, the issue of redistribution of funds never surfaced. However, the new managers pointed out that they would become nearly fully invested immediately and it would be difficult at best to determine how much money they could reinvest if they sold the stock at a profit. Further, they pointed out that under that procedure they would be penalized fee-wise for realizing a profit. They also pointed out that every other fund they manage has similar guidelines.

My purpose in establishing the 6-month interval to re-evaluate the amount of money the Board would leave committed to the various assets was determined by two points as follows: (1) a reasonable time period in which markets could move substantially up or down, and (2) a workable method to timely permit the diversification of the investment portfolio to the Board's original direction. For further consideration I will recommend that the Board establish this procedure for all investment classifications for which the Board has established investment policy guidelines and thereby permitting the Board to re-evaluate its overall investment policy. Additionally, after discussion with Lehman Capital Management, I will recommend that the Board establish 5% of portfolio assets in Emerging Growth stocks as opposed to the $5 million currently committed. My support for this recommendation is that when the Board originally entered into Emerging Growth as an investment diversification area for the SCERS, the $5 million approximated 5% of portfolio assets at that time. Further, as reported to the Board numerous times in the past, an absolute amount of money as compared to percentage of allocation causes unusual work in reporting the investment assets of the System to the Board.

BACKGROUND

On December 27, 1982, preliminary allocation of stocks presently owned by SCERS were made to Alliance Capital and Batterymarch per their request. (The stocks involved, etc. will be discussed in detail in the financial section of this paper.) During the course of this discussion, the equity managers independently raised the issue as to where dividend income, interest income and gain or loss would be maintained. The Treasurer reported to the managers that the practice of the System has been that at the end of each month all dividend income and other increments, etc. thereof derived from the overall investment management of the SCERS is redistributed to the various fund managers according to Board investment diversification policy. The managers responded that they have no such clients for which they manage funds where the increment is returned and redistributed monthly. They pointed out their areas of concern were that a stock purchased could double in value and the sale proceeds generated would be sufficient to purchase another stock which would have initiated an investment decision to make a change. They pointed out that if after each transaction they had to go back and give to the System the amount of gain derived on such sales it would severely hamper their ability to manage the portfolio. Further, they pointed out that this methodology would penalize the manager on a fee basis for taking gains on stocks as well as remove the incentive for a manager to perform.

At this point an informal discussion was held with SCERS counsel on this matter. Counsel advised that there were really two issues raised by the discussion. One was addressed in the contract and the other was a Board policy decision. Counsel advised that the first issue raised deals with the subject of fees and is covered in Section 10 of our contract. Very briefly, this section of the contract states that the fees should be established on . . . "all fees shall be based upon the market value of all invested capital of System for which investment counsel is accountable pursuant to this agreement. . . . " Counsel advised that this language clearly allows for the increment of all capital derived from the investment manager to be used as the basis for establishing fee to the manager.

However, on the second subject, counsel stated that it was a policy decision of the Board as to how funds should be allocated to investment managers and for overall portfolio diversification purposes.

With this guidance I apprised the new fund managers that all increment derived from their initial allocation would accrue to their account and be the basis for which their investment management fee would be established. However, I advised them that as a Board member it would be my position that we should redistribute all monies of the System every six months in accordance with Board policy or permit the Board to re-evaluate its investment diversification policy guidelines. The managers were agreeable to this arrangement and felt it was more reasonable but they would have opted for a longer period if available. I advised the managers that as a Board member and that as a result of the severe gyrations that can occur in all investments over a 12-month period I favored reviewing such actions semi-annually as the longest time period for a manager to accumulate funds as the Board's original policy guidelines indicate. I further advised them that in the event it would be necessary for them to liquidate assets that I would favor a subsequent 6-month period in which to bring their portfolio into compliance with the Board's investment diversification policy. As mentioned in the summary, it should be pointed out that without this informal arrangement that the new fund managers were unwilling to assume investment responsibility pending Board action. With this issue raised, it became apparent to me that this methodology should be established for all investment classifications for which the Board has established policy, i.e. gold and silver, real estate, bonds, etc. Further, as pointed out to the Board in the past on a number of occasions, the Board had committed a sum of $5 million to the Emerging Growth manager as opposed to a percentage of portfolio assets. This arrangement creates unusual extra work in the reporting process to establish the amount of funds authorized by the Board for investment classes. Since the $5 million originally allotted by the Board to Emerging Growth was equivalent to approximately 5% of portfolio assets, I informally discussed with the Emerging Growth manager the concept previously described. The Emerging Growth manager was understanding of and supportive of a change that would result in 5% of the portfolio at book being earmarked for Emerging Growth investment. I advised the Emerging Growth manager that I would present this concept to the Board at the January Board meeting and advise him of their actions.

FINANCIAL

For purposes of establishing the amount of SCERS assets at book for core manager distribution as of January 1, 1983, the latest available SCERS asset statement showed investments with $150.5 million book value. Based on the Board's current authorized diversification policy 30% of such amount, or approximately $45.150 at book, could be invested in equities. By reducing the $5 million available for Emerging Growth, left $40.150 available for the core managers.

For allocation purposes, $20 million was designated available for both Alliance Capital and Batterymarch as of January 1, 1983. As of December 31, 1982, the total amount of core equity investments (including bonds, convertible debentures and stocks for which covered call options had been written) was $26,545,543 book value (see Attachment A, B, & C). Per Board discussion, $4,816,043 book value of common stocks for which covered core options had been written (see Attachment A) were earmarked to be held until the options were exercised or covered at which time the stocks would be sold and the proceeds given back to the System.

Of the $2,816,878 which represented U. S. Treasury Notes and convertible subordinated debentures, these securities were sold (see Attachment B). Of the remaining stocks, Alliance Capital Management selected $6,427,240 book value of securities (see Attachment C) that they wish to retain. These securities were transferred to a new account at Wells Fargo Bank and designated as investment securities for Alliance Capital Management. Addtionally, Alliance was advised that they had $13,573,000 in cash available for reinvestment and that our office would advise them monthly of all increments derived and remaining balances they have available for investment as well as the amount of investment income earned on cash reserves authorized but not invested in common stocks.

Batterymarch agreed to take all remaining investment securities of the former manager. Such securities totalled $12,485,382 at book and were transferred to a separate account at Wells Fargo Bank designated for Batterymarch investment management (see Attach. B) $7.515 million was additionally transferred to Wells Fargo Bank and invested for SCERS through their Overland Express account for Batterymarch but earmarked as Batterymarch Investment Manager. At this point Batterymarch and Wells Fargo Bank established computer relations whereas Batterymarch is aware of the securities owned and the cash available in the Overland Express account. All future dividends, interest and increments whatsoever derived from this money will automatically be deposited in the trust account and swept into the Overland cash management account all of which will be used electronically by Batterymarch for the purposes of making future investments.

As of this writing, I can advise the Board that both Alliance and Batterymarch have initiated a number of investment transactons. To date the Treasurer's Office has executed all investment activity for Alliance Capital at or below their limit prices. Batterymarch has been executing investment transactions as they had previously described to the Board and information relating to such activity is being captured in the City Treasurer's Office via the Moneymax computer terminal in the Treasurer's Office.

RECOMMENDATION

That the SCERS Board adopt the following investment policy guidelines:

1. That all increment derived by a fund manager of SCERS assets innure to that investment classification, and

2. That every 6 months the City Treasurer redistribute all increments, etc. derived from investment management according to the Board's overall adopted investment diversification policy, or the Board re-evaluate its overall investment diversification policy, and

3. The Board adopt that as of January 1, 1983, 5% of SCERS assets at book be designated as the authorized limit for the Emerging Growth manager.

Respectfully submitted,

THOMAS P. FRIERY
City Treasurer

TPF/lv
Attachments

cc: Alliance Capital Mgmt.
Batterymarch
Lehman Management
Jim Smith

ATTACHMENT A

(TIONS ARE WRI(EN

	Initials	Date
Prepared By		
Approved By		

	DESCRIPTION	1 Position	2 Cost	3 11-30-82 Market	4 12-28-82 Market
Jan					
50^{00}	Johnson & Johnson	10000	31826800	46500000	500000 -
$87\frac{3}{4}$	Eastman Kodak	6000	51054600	56550000	526500 -
$54\frac{1}{8}$	Dayton Hudson	9000	46990000	54225000	487125 -
$60\frac{1}{2}$	Merrill Lynch	10000	47920300	69000000	605000 -
45^{00}	Cigna Corp	9000	37093700	41850000	405000 -
$95\frac{1}{8}$	Int'l Bus Machs	6000	41514700	51900000	570750 -
$21\frac{1}{8}$	Storage Tech	7500	25000000	19993900	158438 -
$37\frac{1}{2}$	Xerox Corp	6000	47523000	23250000	225000 -
$76\frac{1}{4}$	Minnesota Mng & Mfg.	6000	37710000	44475000	457500 -
			366539100	402343900	3935313 -

		Position	Cost	Market	Market
Feb					
$41\frac{3}{4}$	Searle, G.D.	7500	29993800	31875000	313125 -
$45\frac{3}{8}$	Safeway Stores	400	1747400	1920000	181500 -
$75\frac{1}{2}$	Hewlett Packard	4000	9499400	29000000	302000 -
$86\frac{3}{4}$	Honeywell Inc	3000	21313800	30300000	260250 -
$13\frac{3}{8}$	Reading & Bates Corp	10000	18520000	12500000	133750 -
41^{00}	McDonnell Douglas	7500	34101900	30187500	307500 -
			115066200	135782500	1498125 -

Total Book Value $4816043 -

Option Settlement Date is the Saturday following the third Friday.

415 - 434 - 4405

555 Calif St
Suite 2475
SF 941(

ALLIANCE

ATTACHMENT C

	Initials	Date
Prepared By		
Approved By		

		1	2	3	4
				11-30-82	12-23-82
	Description	Position	Cost	Market	Market
50 00	Johnson & Johnson	10000	318270 00	465000 00	500000 00
70 00	PFIZER INC	11500	655421 00	842375 00	805000 00
51 3/4	R.J. Reynold's Industries	4026	124315 00	193281 00	208345 50
54 1/8	Dayton Hudson	9000	466900 00	542250 00	487125 00
70 00	Melville Corporation	15000	649325 00	1042500 00	1050000 00
60 1/2	Merrill Lynch	10000	479240 00	670000 00	605000 00
*51 1/2	TIME INC.	22500	659160 00	1071563 00	1158750 00
25 1/8	Federal Nat'l Mtg Assn	50000	840253 00	1162500 00	1256250 00
40 1/2	GTE CORP	25000	746039 00	1031250 00	1012500 00
75 1/2	Hewlett Packard	4000	94996 00	290000 00	302000 00
86 3/4	Honeywell Inc	7000	497325 00	707000 00	607250 00
95 1/8	Int'l Bus Machs	6000	415152 00	519000 00	570750 00
44 5/8	Sundstrand Corp	15000	480325 00	612750 00	669375 00
			6427240 00	9180469 00	9232345 50

4604 (64604) — Buff
8804 (88804) — Green