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MEETING DATE
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AGENDA ITEM
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Memorandum

Date: February 13, 2012
To: CCCERA
From: Timothy Price and Bob Helliesen
Subject: Recommendation to Allow Emerging Markets in GMO Strategy

Overview and Recommendation

GMO has managed an international, developed markets value-oriented strategy for CCCERA since 2004. Milliman has advocated the judicious use of emerging markets within the international equity portfolios. However, at the time that GMO was hired (and until very recently), the firm only had a developed market version of the International Intrinsic Value strategy. While GMO has also managed stand-along emerging markets strategies out of the Berkeley office, these did not follow the value approach of CCCERA's mandate. Due to client feedback, including from CCCERA, GMO has recently launched a version of the International Intrinsic Value strategy that invests across both developed and emerging markets. The strategy is known as International Intrinsic Value Extended Markets strategy and is managed by the same portfolio manager, Tom Hancock. Milliman recommends that CCCERA shift from the current strategy to the extended market strategy.

CCCERA Historical use of Emerging Markets

CCCERA has used a modest amount of emerging markets for the past decade. GMO was hired in 2004 to act as a complement to the Capital Guardian portfolio, which had a slight growth bias and included an explicit emerging markets sleeve. When Capital Guardian was terminated in 2005, McKinley was hired. The McKinley strategy also allowed the used of emerging markets. Likewise, when William Blair replaced McKinley in 2010, the William Blair mandate specified an allocation to emerging markets of 10-35% and uses the MSCI ACWI ex-US IMI Growth (large and small cap, developed and emerging markets) benchmark.

Product Assessment

Because the GMO strategy is run using a number of quantitative tools, we asked the firm to prepare a back-test of how the strategy would have performed since 2005. Back test results by their nature are subject to a number of going-in assumptions. The GMO back test included the following assumptions:

- GMO applied the investment process for the GMO International Intrinsic Value Strategy to a universe of securities that is generally represented by the MSCI All-Country World ex US Index. The investment process applies two separate valuation-based stock-selection models to the investment universe at approximately an 80% weight and two momentum-based stock-selection models at approximately a 20% weight.
- The hypothetical portfolio was rebalanced monthly.
- No tactical shift between the three stock selection models was assumed.
- The hypothetical portfolio assumed a constant 2.5% cash allocation.

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Performance of GMO Strategies

Cumulative Performance through December 31, 2011

Firm	Quarter	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	7 Yrs	10 Yrs
Int'l Intrinsic Value	2.66	-9.59	-1.08	6.14	-7.93	-4.42	2.13	7.77
MSCI EAFE Value (GD)	**2.82**	**-11.65**	**-4.23**	**7.40**	**-8.61**	**-5.77**	**1.55**	**5.53**
Int'l Intrinsic Value Ext Mkt	3.65	-12.30	-1.70	8.98	-8.90	-3.56	4.24	---
MSCI ACWI ex-US Value (GD)	**3.40**	**-12.71**	**-2.72**	**11.16**	**-6.82**	**-3.17**	**3.82**	**7.52**

Note: Periods greater than 1 year are annualized

Annual Performance through December 31, 2011

Firm	2011	2010	2009	2008	2007	2006	2005
Int'l Intrinsic Value	-9.59	8.23	22.19	-39.89	10.97	26.63	14.75
MSCI EAFE Value (GD)	**-11.65**	**3.81**	**35.06**	**-43.68**	**6.49**	**31.05**	**14.39**
Int'l Intrinsic Value Ext Mkt	-12.30	10.18	33.96	-46.78	21.08	29.95	23.37
MSCI ACWI ex-US Value (GD)	**-12.71**	**8.40**	**45.14**	**-45.10**	**12.87**	**30.41**	**17.15**

Risk Statistics - Annualized Three Years
Periods Ending December 31, 2011

Firm	Excess	Std Dev	Trk Err	Info	Sharpe	Alpha	Beta	R-Sqr
Int'l Intrinsic Value	-1.26	25.78	5.53	-0.23	0.23	-0.50	0.85	0.98
MSCI EAFE Value (GD)	**0.00**	**30.02**	**0.00**	**---**	**0.24**	**0.00**	**1.00**	**1.00**
Int'l Intrinsic Value Ext Mkt	-2.17	28.53	3.27	-0.66	0.31	-1.62	0.96	0.99
MSCI ACWI ex-US Value (GD)	**0.00**	**29.52**	**0.00**	**---**	**0.37**	**0.00**	**1.00**	**1.00**

Risk Statistics - Annualized Five Years
Periods Ending December 31, 2011

Firm	Excess	Std Dev	Trk Err	Info	Sharpe	Alpha	Beta	R-Sqr
Int'l Intrinsic Value	1.35	23.98	4.76	0.28	-0.24	0.43	0.88	0.98
MSCI EAFE Value (GD)	**0.00**	**27.11**	**0.00**	**---**	**-0.26**	**0.00**	**1.00**	**1.00**
Int'l Intrinsic Value Ext Mkt	-0.39	27.78	3.63	-0.11	-0.18	-0.26	1.00	0.98
MSCI ACWI ex-US Value (GD)	**0.00**	**27.63**	**0.00**	**---**	**-0.16**	**0.00**	**1.00**	**1.00**

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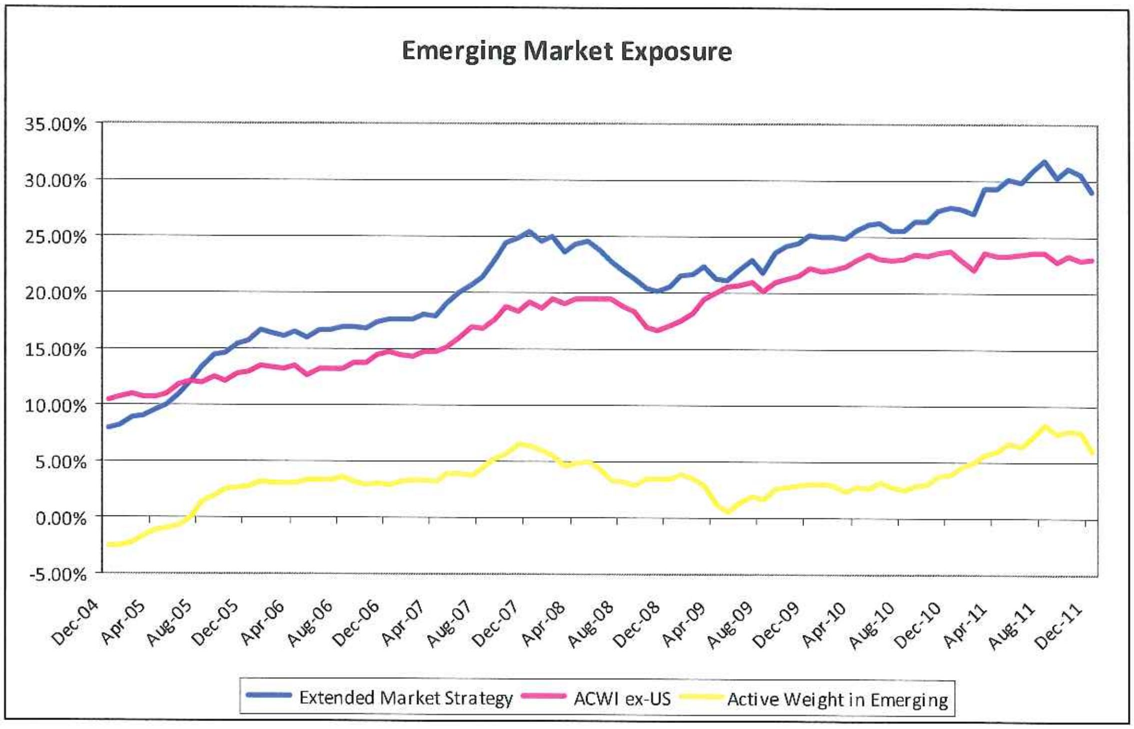
The emerging market allocation of the Extended Market strategy back test ranged from 8-32%. Over this same period, the MSCI ACWI ex-US benchmark has ranged from 10-24%. This represents active weights relative to the benchmark of -3% to +8%. The current position is 6% higher than the index. We feel that this is a reasonable allocation to emerging markets.



Fees

CCCERA is invested in a mutual fund for the current International Intrinsic Value strategy. If the shift to the extended market strategy is approved by the Board, the current investment will be sold and the proceeds will be invested in the new International Intrinsic Value Extended Market fund. The fee structure will be unchanged at 59 basis points for the Class IV shares (current share class).

Conclusion

Allowing GMO to use emerging markets while maintaining the current investment philosophy is a prudent decision. This will permit GMO to apply its stock-picking models to a broader opportunity set. The use of emerging markets is consistent with CCCERA's long-term goals to globally diversify the equity exposure. We recommend that the CCCERA allocation be moved to the Extended Market strategy, subject to legal review of the new fund's documentation.