



San Mateo County, State of California

POPULAR ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2018



NAVIGATING THE FUTURE

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INTRODUCTION

This Popular Annual Financial Report (PAFR) is a condensed version of the San Mateo County Employees' Retirement Association's (SamCERA) Comprehensive Annual Financial Report (CAFR), which is prepared in accordance with generally accepted accounting principles in the United States of America. The CAFR provides in-depth information about the financial, investment, actuarial, statistical, and compliance aspects of SamCERA and is available online at www.samcera.org.

For the 15th consecutive year, the Government Finance Officers Association of the United States and Canada presented an award for Outstanding Achievement in PAFR to SamCERA in recognition of its PAFR for the fiscal year ended June 30, 2017.



ABOUT SAMCERA

SamCERA is a cost-sharing multiple-employer, defined benefit pension plan established to provide pension benefits for predominantly all permanent employees of the County of San Mateo (the County), the Superior Court of the County of San Mateo, and the San Mateo County Mosquito and Vector Control District. As of June 30, 2018, SamCERA had a total of 12,142 members.

The management of SamCERA is vested in the Board of Retirement consisting of nine members:

- the first member is the County Treasurer;
- the second and third members are general members of SamCERA elected by their peers;
- the fourth, fifth, sixth and ninth members are qualified electors of the County and appointed by the County Board of Supervisors;
- the seventh member is elected by and a member of SamCERA's safety membership; and
- the eighth member is a retired member elected from the retired membership.

In addition, there is one elected Safety Member Alternate and one elected Retired Member Alternate.

MISSION & GOALS

SamCERA exists to serve as loyal fiduciary for its members and as prudent administrator of the retirement system. SamCERA will continue to pursue its three major goals:

- Provide caring, fair, accurate, timely and knowledgeable professional services and information to members and other stakeholders.
- Prudently manage the assets in order to appropriately fund the actuarial liabilities of the retirement system to ensure the ability to pay all earned benefits while minimizing the costs to employers.
- Constantly improve the effectiveness of SamCERA's services and the efficiency of its operations.

A MESSAGE FROM THE CEO



As SamCERA approaches its 75th anniversary next year, we wanted to not only reflect on our past, but also take a look at where we are headed. As the retirement fund administrator serving employees from San Mateo County, the San Mateo Superior Court, and the San Mateo County Mosquito and Vector Control District, SamCERA's operations are focused on the prudent management of the Fund to provide a secure future for our members.

The Fund remained healthy over fiscal year (FY) 2017-18, and although investment returns of 6.70% fell slightly short of the 6.75% assumed rate of return, SamCERA's funded level had steady improvement with a 3.2% increase bringing the funded ratio to 87.5%. This increase was due primarily to employer contributions, including supplemental contributions that are intended to accelerate the elimination of the unfunded liability created by the financial crisis of 2008-2009 and due to the recognition of investment gains.

SamCERA's Board continues to implement its updated asset allocation policy, which began last fiscal year and is anticipated to be fully implemented by year 2020. Some allocations such as private real assets and real estate are expected to take longer to implement. During FY 2017-18, the allocation to U.S. equity was reduced and the allocation to inflation hedge assets was increased. Also, as a result of an annual review of the policy portfolio, exposure to alternatives was reduced and public equity was increased. These changes are reflective of SamCERA's efforts to actively rebalance the portfolio to its long-term asset allocation policy, with the goal to keep a balanced risk posture without relying too much on any single asset, strategy, or return stream.

As it has for the past 74 years, SamCERA will continue to navigate its way through smooth and rough economic waters with a sense of direction, purpose and vision to ensure benefits for our membership.

Scott Hood

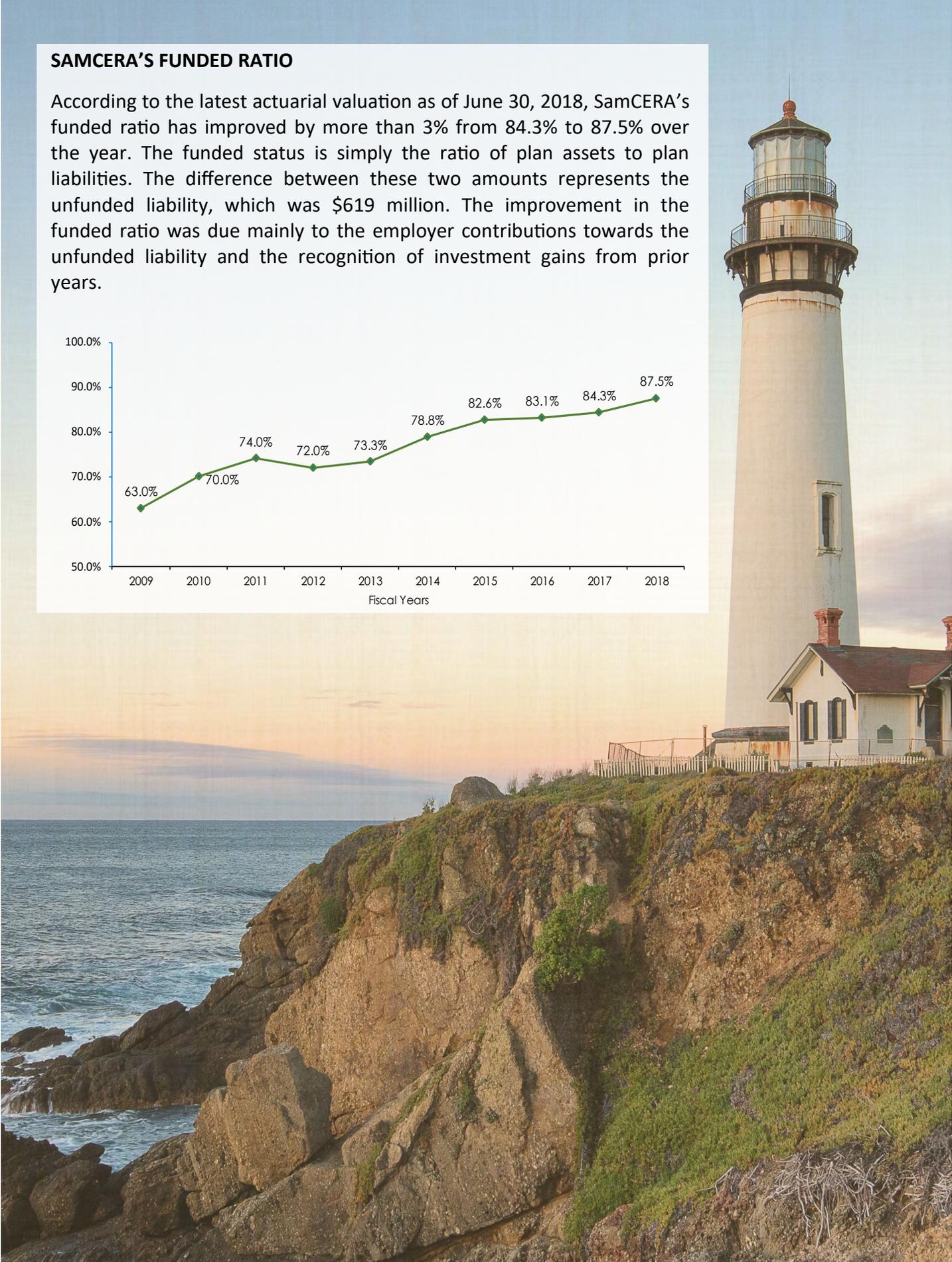
A handwritten signature in blue ink, appearing to read "S. Hood". The signature is fluid and cursive.

SamCERA
Chief Executive Officer



SAMCERA'S FUNDED RATIO

According to the latest actuarial valuation as of June 30, 2018, SamCERA's funded ratio has improved by more than 3% from 84.3% to 87.5% over the year. The funded status is simply the ratio of plan assets to plan liabilities. The difference between these two amounts represents the unfunded liability, which was \$619 million. The improvement in the funded ratio was due mainly to the employer contributions towards the unfunded liability and the recognition of investment gains from prior years.





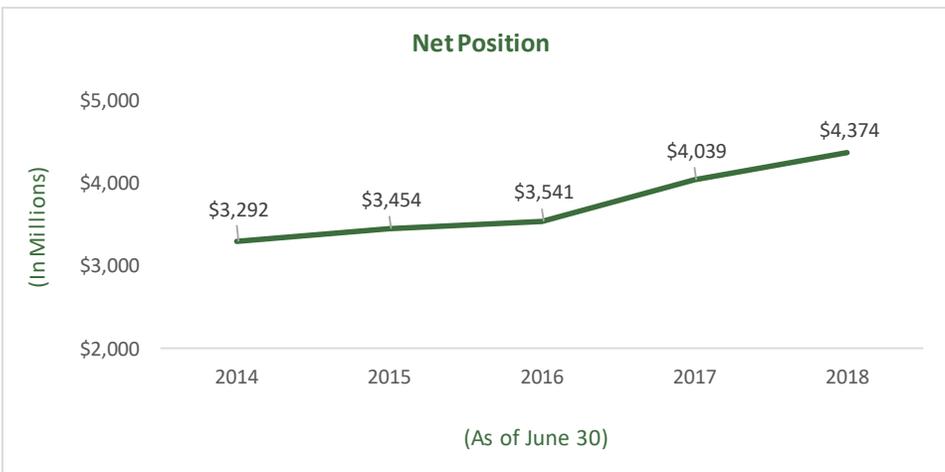
The **STATEMENT OF FIDUCIARY NET POSITION** is a snapshot of account balances at fiscal year-end. The difference between assets and liabilities is “net position,” which represents funds available to pay pension benefits. As of June 30, 2018, SamCERA’s net position increased by 8% to \$4.4 billion. The increase was mainly from investment earnings and supplemental contributions from the County of San Mateo .

Statement of Fiduciary Net Position
(Dollars in Thousands)

	2018	2017	Increase (Decrease)	
			Amount	Percentage
Assets				
Cash and cash equivalents	\$ 53,125	\$ 192,194	\$ (139,069)	-72%
Cash management overlay	12,984	25,208	(12,224)	-48%
Securities lending cash collateral	1,486	-	1,486	-
Receivables	19,611	25,399	(5,788)	-23%
Prepaid expense	8	8	-	0%
Investments at fair value	4,289,745	3,802,162	487,583	13%
Capital assets, net	6,804	7,629	(825)	-11%
Total assets	4,383,763	4,052,600	331,163	8%
Liabilities				
Investment management fees	1,663	1,822	(159)	-9%
Due to broker for investments purchased	5,408	9,417	(4,009)	-43%
Collateral payable for securities lending	1,489	-	1,489	-
Other	1,241	2,659	(1,418)	-53%
Total liabilities	9,801	13,898	(4,097)	-29%
Net position restricted for pensions	\$ 4,373,962	\$ 4,038,702	\$ 335,260	8%

Most of the cash at June 30, 2017, was used in year 2018 for new investment purchases, part of the strategy to implement the new asset allocation approved by the Board of Retirement.

The increase came partially from market appreciation and partially from new investment purchases.



The **STATEMENT OF CHANGES IN FIDUCIARY NET POSITION** provides information about SamCERA's financial activities during the reporting period that increased or decreased the Net Position Restricted for Pensions.

In fiscal year 2018, SamCERA's net position increased by about \$335 million, which was mainly from employer contributions and investment earnings.



Statement of Changes in Fiduciary Net Position
(In Thousands)

	2018	2017	Increase (Decrease)	
			Amount	Percentage
Additions				
Employer contributions	\$ 207,257	\$ 198,727	\$ 8,530	4%
Member contributions	64,204	62,160	2,044	3%
Net investment income	280,076	436,603	(156,527)	-36%
Net securities lending income	43	46	(3)	-7%
Other	27	27	-	0%
Total additions	551,607	697,563	(145,956)	-21%
Deductions				
Service retirement benefits	179,880	166,975	12,905	8%
Disability retirement benefits	23,872	22,690	1,182	5%
Survivor, death and other benefits	976	699	277	40%
Member refunds	4,326	2,876	1,450	50%
Administrative expenses	5,849	5,983	(134)	-2%
Information Technology expenses	1,444	996	448	45%
Other expenses	-	30	(30)	-100%
Total deductions	216,347	200,249	16,098	8%
Changes in net position	335,260	497,314	(162,054)	-33%
Net position restricted for pensions				
Beginning of year	4,038,702	3,541,388	497,314	14%
End of year	\$ 4,373,962	\$4,038,702	\$ 335,260	8%

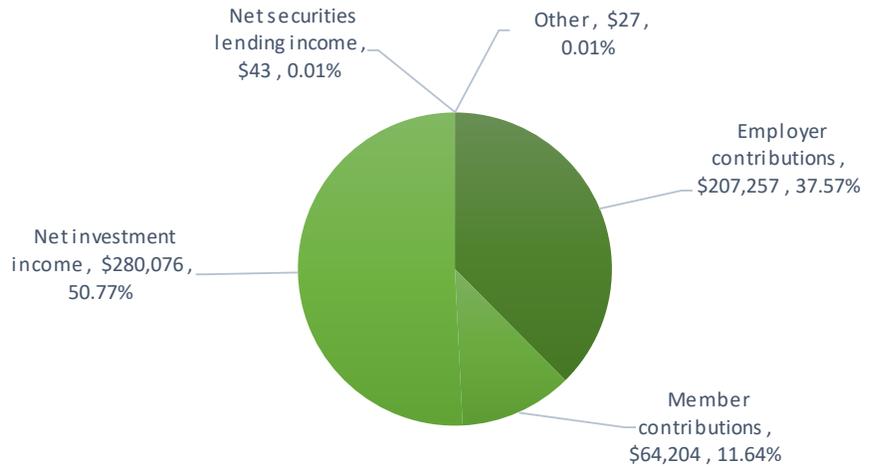
Employer contributions went up after SamCERA lowered its assumed investment return by a quarter percent.

Investment return slipped to 6.7% this year from 12.6% last year. Public equity and alternatives were the main detractors from performance.

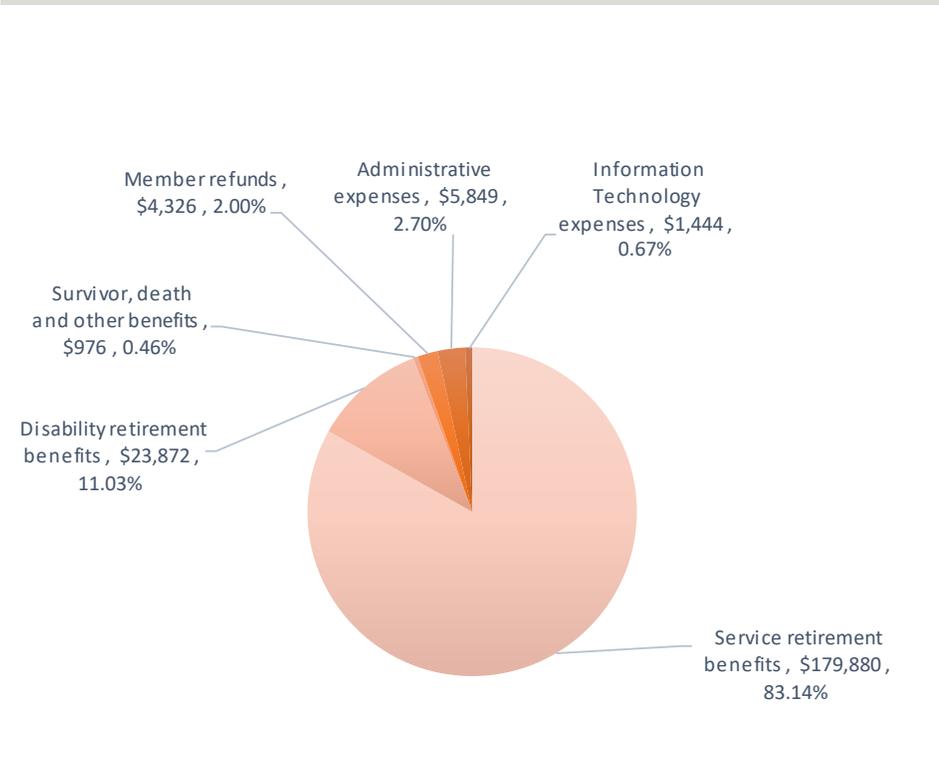
Higher benefits were due mainly to an increase in the number of retirees with a relatively higher final average compensation.



WHERE DID SAMCERA'S MONEY COME FROM?
For the Fiscal Year Ended June 30, 2018 (Dollars in Thousands)



WHERE DID SAMCERA'S MONEY GO TO?
For the Fiscal Year Ended June 30, 2018 (Dollars in Thousands)



INVESTMENT POICY

SamCERA’s Investment Policy is aimed at reducing risk through a prudent diversification of the investment portfolio across a broad selection of distinct classes. The Board conducted an asset-liability study in fiscal year 2017 and subsequently approved a new target asset allocation. The Board undertakes an in-depth asset and liability study every three to five years.

ASSET ALLOCATION

During the fiscal year, the Board adjusted the target policy asset allocation that was initially set in October 2016. The new policy reduced exposure to alternatives and increased exposure to public equity. The Board also approved an allocation to include low volatility equity and a 50% currency hedge for developed international equity. The new target policy consists of 37% in public equity, 23% in fixed income, 12% in alternatives, 8% in risk parity and 20% in inflation hedge. Implementation of the new policy will take multiple phases and is anticipated to be completed by year 2020.

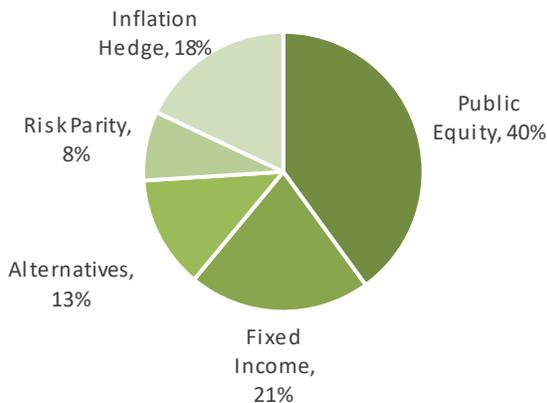
Due to the multiple phase process, SamCERA’s Investment Policy at June 30, 2018, only reflected the portion of the newly adopted asset allocation that has already been implemented. This interim target allocation policy is referred as “Interim Policy.”

Asset Class	Target Policy	Interim Policy	Actual
Public Equity	37%	40%	41.6%
Fixed Income	23%	21%	20.5%
Alternatives	12%	13%	11.8%
Risk Parity	8%	8%	7.1%
Inflation Hedge	20%	18%	17.5%
Cash Equivalents	0%	0%	1.5%
Total	100%	100%	100.0%

ASSET CLASS	Assets Under Management
Public Equity	\$ 1,809,329,959
Fixed Income	892,923,149
Alternatives	514,972,248
Risk Parity	311,126,425
Inflation Hedge	761,393,517
Total Net Portfolio Value	\$ 4,289,745,298

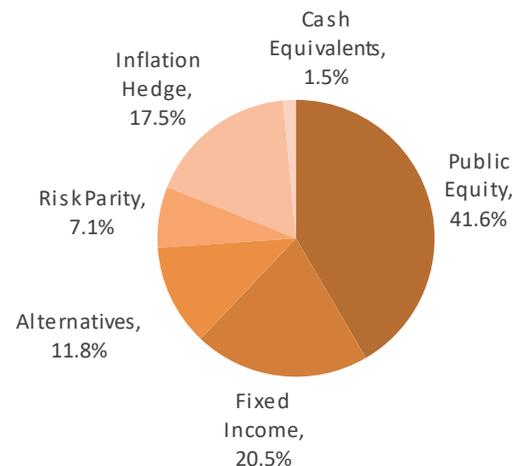
Target Asset Allocation Under Interim Policy

June 30, 2018



Actual Asset Allocation

June 30, 2018



INVESTMENT PORTFOLIO PERFORMANCE

SamCERA's portfolio market value increased to \$4.37 billion as of June 30, 2018, as the net combination of portfolio appreciation and contributions, less total deductions (i.e., benefits paid, administrative expense, etc.), added approximately \$335 million to the fund.

SamCERA's portfolio returned 6.7% net of investment management fees for the fiscal year ended June 30, 2018, underperforming SamCERA's policy benchmark return by 1.1%. This fiscal-year performance resulted in a 4th quartile performance relative to SamCERA's peers, as defined by large (greater than \$1 billion in assets) public plans.



SamCERA Composite Net Performance for Trailing Year Ended June 30, 2018

Composite	Amount	Allocation	Composite Return	Benchmark Return	Excess Return
Public Equity	\$ 1,809,329,959	41.6%	10.9%	11.8%	-0.9%
Fixed Income	892,923,149	20.5%	1.0%	0.0%	1.0%
Alternatives	514,972,248	11.8%	2.6%	10.0%	-7.4%
Risk Parity	311,126,425	7.1%	6.6%	7.3%	-0.7%
Inflation Hedge	761,393,517	17.5%	6.7%	7.2%	-0.5%

Note: Cash balance was 1.5% as of June 30, 2018.

SamCERA Total Fund Net Performance Characteristics Ended June 30, 2018

	1 Year	3 Years	5 Years	10 Years
SamCERA Return	6.7%	6.5%	8.0%	6.1%
Benchmark Return	7.8%	7.0%	8.2%	6.8%
Excess Return	-1.1%	-0.5%	-0.2%	-0.7%
Peer Rank Return (Percentile)	92nd	57th	41st	48th
SamCERA Risk (Standard Deviation)	4.5	6.1	6	10.2
Benchmark Risk (Standard Deviation)	4.9	6.6	6.4	10.8
SamCERA Sharpe Ratio	1.2	1	1.3	0.6
Benchmark Sharpe Ratio	1.3	1	1.2	0.6



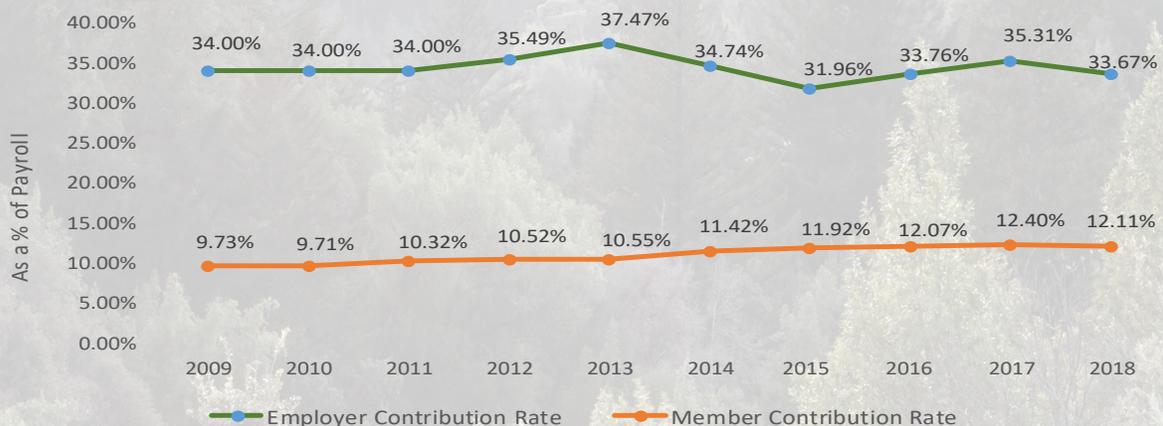
With the backdrop of potentially more divergent growth prospects (and the resulting divergent policy responses) across the globe, SamCERA continues to be mindful of higher potential return volatility caused by a potential policy misstep. Moreover, given that we are most likely in the late stages of the economic cycle, and with record high equity prices in the U.S., we believe that it is extremely important in this environment to understand the risks one is taking in generating the return stream they are receiving from their portfolio.

With that thought in mind, SamCERA continues to actively rebalance the portfolio to its long-term policy asset allocation weights to keep a balanced risk posture without relying too much on any single asset, strategy, or return stream.

EMPLOYER AND MEMBER CONTRIBUTION RATES (DETERMINED AT JUNE 30)

SamCERA retains an independent actuary to perform an annual actuarial valuation. The purpose of this valuation is two-fold: (1) to determine required contributions from employers and members to pay the projected future benefits, and (2) to monitor SamCERA's funded status.

Contributions are based on various factors such as market fluctuations, plan amendments, and changes in actuarial assumptions and member demographics. The funded ratio compares SamCERA's assets and liabilities as a measure of its financial health at a point in time. The contribution rates determined as of the valuation date will become effective a year later. For example, the contribution rates determined as of June 30, 2018, will become effective on July 1, 2019.



A photograph of a sailboat on the ocean at sunset. The sun is low on the horizon, creating a warm, golden glow. The sailboat's mast and rigging are visible on the right side of the frame. The water is a deep blue with white foam from the boat's wake. In the background, a range of mountains is visible under a hazy sky.

**“It is not the ship so much as the
skillful sailing that assures the
prosperous voyage.”**

**-George William Curtis
*American Writer***