



SACRAMENTO COUNTY
EMPLOYEES'
RETIREMENT SYSTEM

INVESTMENT POLICY & OBJECTIVES

January 17, 2008
As Amended June 18, 2008,
December 18, 2008,
and February 18, 2010



FOREWORD

The Sacramento County Employees' Retirement System ("SCERS") was created on July 1, 1941, by Sacramento County Ordinance #283 as adopted by the Board of Supervisors on April 30, 1941, pursuant to the County Employees' Retirement Law of 1937. SCERS provides retirement, disability, and death benefits for qualified employees of Sacramento County and eleven participating special districts.

A nine member Board of Retirement (Board) governs SCERS. The Board has sole and exclusive fiduciary responsibility over the assets of the retirement system. The Board has the sole and exclusive responsibility to administer SCERS in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The authority of the Board in the above matters is plenary or absolute. See California Constitution at Articles XVI Section 17.

While the Board has the above authority noted above, the organizational structure of SCERS focuses the attention of the Board on governance and policy and not on the management of the system. Thus, the primary responsibility of the Board is strategic in setting the direction of SCERS. This includes enunciation of the mission and setting of goals and objectives.

SCERS' Chief Executive Officer (CEO) has the responsibility for the overall management and administration of the system in accordance with the direction, policy and goals set by the Board. Reporting to the CEO as part of the executive staff is the Chief Investment Officer (CIO). The CIO has primary responsibility in cooperation with the CEO for SCERS' investment program.

An annual actuarial valuation commissioned by the Board determines contributions into the Sacramento County Employees' Retirement Fund (Fund). The growth of the Fund results from a combination of employer and employee contributions and the net return, less the administrative and investment costs, achieved from investing the assets.

The Purpose of this Investment Policy and Objectives is to:

1. Articulate the Board's views on SCERS' investment objectives and risk tolerance for the investment portfolio.
2. Establish performance standards to measure the success of achieving the objectives.
3. Formulate the Board's policies and guidelines on: a) asset allocation and diversification of investments; b) identification of permissible investments; c) the structure and framework for the investment portfolio; d) implementing the policies; e) prudently monitoring and evaluating the performance and risk of the investment portfolio; and f) investment manager termination.

SCERS INVESTMENT GOALS

1. Provide for Present and Future Benefit Payments - The overall purpose of SCERS is to invest pension assets, solely in the interest of providing benefits to the participants and their beneficiaries, while attempting to minimize the employer contributions and defraying the administrative costs. The investment of contributions and other fund assets in accordance with the investment policy described herein will accomplish this and maintain adequate funding of SCERS' liabilities over time.

The goal of the Board is to design an investment portfolio that will achieve and exceed the actuarial rate of return assumption of 7.875% over a market cycle. The Board will strive to achieve this level of return with a high level of certainty.

2. Make Prudent Investments - With care, skill, prudence and diligence the Board will strive to produce an investment return based on levels of liquidity and investment risk that are prudent and reasonable under present circumstances. Such circumstances may change over time.
3. Diversify the Assets - The Board will diversify the investments of the Fund to maximize the investment return with acceptable investment risk.
4. Create Reasonable Pension Investments Relative to Other Pension Funds - The pension investment program must operate in compliance with all applicable State and Federal laws and regulations concerning the investment of pension assets. SCERS judges its selection of investment vehicles and policies against other private and public pension funds, with special emphasis on comparisons with public funds.
5. Establish Policy and Objectives Review Process - Annually, SCERS will conduct a formal review of its Investment Policy and Objectives and will develop an updated financial projection at least every five years.

RISK VS. RETURN

In general, research has shown that investments that involve greater risks offer a higher expected return. The Board will seek to achieve the performance goals previously outlined with the lowest acceptable level of risk. To achieve the actuarial target earnings goal with a high level of certainty, the Board has adopted a strategic asset allocation plan with an expected annualized passive return of 7.96% over a 10-year period. This asset allocation is expected to have an annualized standard deviation of 11.56%. SCERS will utilize active investment management strategies to add the additional return required to achieve the target earnings rate. The Board strives to seek a balance between the certainties of obtaining a set return over time with the risks inherent in higher return investments.

The annualized passive return for the strategic asset allocation is different from the target earnings rate because the asset allocation capital market assumptions are for a shorter forecast time horizon and the inflation assumption used in the developing the actuarial rate of return is lower.

PERFORMANCE OBJECTIVES

SCERS' performance objectives provide the Board with benchmarks to measure the performance of the investment policy and the guidelines. The performance objectives are divided into three components: first level objectives for the Total Fund; second level objectives for each asset class; and, third level objectives for the individual portfolio components. The performance evaluator will incorporate all three levels in its quarterly review of the Fund's performance.

The first level: Total Fund (Detailed Below)

The Total Fund has both an absolute and several relative performance objectives.

1. **Achieve the actuarial rate of interest.** The Fund will strive to earn a net investment return equal to or in excess of the assumed annualized actuarial rate of interest of 7.875% over rolling five year periods.
2. **Relative to the asset allocation targets, generate a return in excess of the passive benchmark portfolio.** The Board will establish a passive benchmark index, which reflects SCERS' unique asset allocation policy. Exceeding this benchmark indicates that the investment management structure of the various portfolio components has added value over a passively managed fund with a similar asset mix.
3. **Exceed the rate of inflation.** 5% more than Consumer Price Index , All Items- U.S. City Average, All Urban Consumers (CPI-U) as reported by the Bureau of Labor Statistics.
4. **Comparison relative to peer group of similar funds.** Exceed the median return at a comparable or lower level of risk compared to a similar peer group of public employee pension funds. The investment consultant will provide a comparative analysis of the Fund's comparable risk versus return.

FIVE YEAR PERFORMANCE OBJECTIVES

Total Fund

1. Annualized Return to Exceed the Assumed Actuarial Rate of Interest:

Return above 7.875%.

2. Return to Exceed the Return of the Passive Benchmark Portfolio:

30%	x	Russell 3000
5%	x	Annualized 91-day T-Bill Rate plus 5%
20%	x	Barclay's Capital Aggregate Bond Index
20%	x	MSCI EAFE Index
12%	x	NCREIF Property Index
3%	x	NAREIT Equity Index
5%	x	Private Equity Benchmark
5%	x	Dow Jones UBS Commodities Index

3. Return Relative to Inflation: 5% more than Consumer Price Index, All Items- U.S. City Average, All Urban Consumers (CPI-U) as reported by the Bureau of Labor Statistics.

4. Return Relative to Similar Public Employee Retirement Systems:

- Rank in the top forty percent of the State Association of County Retirement Systems (SACRS) performance comparison.
- Rank below the median portfolio risk in SACRS and other appropriate peer performance comparisons.

The second and third level: Asset Classes and Individual Investment Managers

To achieve SCERS' performance objectives the Board has developed second and third level performance objectives to review the details of the investment portfolio. These second and third level performance objectives cover each asset class and each individual manager. These performance objectives are relative to each asset class benchmark; each investment manager specified benchmark and appropriate style peer group. The objectives for each asset class are listed below. The objectives for each investment manager are listed on pages twenty (20) and twenty-one (21).

The asset allocation accounts for at least 90% of the investment return. Differences in the strategic asset allocation will at times make performance comparisons with other plans difficult. Experience has shown that investment managers do not always meet their objectives. Recognizing this, it is important to keep in mind that the attainment of the five-year performance objectives may be very difficult. Meeting the five-year performance objectives is SCERS' performance goal. Performance that is close to the objectives will be of significant financial benefit to SCERS' financial condition. Failure to reach the goal may not necessarily reflect a deficiency in SCERS' investment objectives.

**FIVE YEAR ASSET CLASS
INVESTMENT RETURN OBJECTIVES**
(Net of Fees)
As a subset of the Total Fund Objective

EQUITIES:

Domestic Equity Large Cap	Russell 1000 Index plus 100 basis points for active managers and 60 basis points overall, including the passive allocation.
Domestic Equity Small Cap	Russell 2000 Index plus 150 basis points
Equity Long/Short Hedge Fund	91 Day T-Bill plus 500 basis points
International Equity	MSCI EAFE Index plus 100 basis points
Emerging Markets	MSCI EMF Index plus 150 basis points
Private Equity	S&P 500 plus 200 basis points

FIXED INCOME:

Fixed Income	Barclays Capital Aggregate Index plus 70 basis points
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REAL ESTATE:

Private Market Core	NCREIF Index plus 100 basis points
Private Market Value Added	NCREIF Index plus 200 basis points
Public Equity Securities	NAREIT Equity Index plus 100 basis points

OPPORTUNITIES:

Opportunities Strategies	Dow Jones UBS Commodities Index plus 100 basis points
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CASH:

Cash	State Street STIF
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Strategic Overlay

Passive Return of SCERS' Asset Allocation,
excluding the real estate asset class.

The objectives established in the three levels set a high standard of performance for SCERS' investments. The attainment of these objectives is dependent upon the SCERS' matching its asset allocation, and upon SCERS' investment managers generating superior rates of return.

RISK CONSTRAINT STATEMENT

RISK MEASURED BY VOLATILITY

There are numerous risks inherent in every asset class. The quantitative measurement of most, but not all, of these risks is done by evaluating the volatility of the asset class returns over time. The key is measurement over enough time to pick up some of the long-term risks, which are not apparent on a short-term basis. Volatility is a statistical measure of the frequency and size of deviations from an average return. The typical measure of volatility is standard deviation. One standard deviation is the range that returns will fluctuate within two-thirds or 66% of the time.

RISK MEASURED BY FUNDAMENTAL FACTORS

There are risks inherent in various asset classes, especially those that do not trade regularly or are not regularly marked to market, that do not show up in the short-term pricing of assets. These fundamental risks such as credit risk, defaults, interest rate sensitivity, investment duration and economic cycles do show up over longer periods. Many of these risks are qualitative in nature. As such, they are measured by individual perception.

Long-term measurements of price volatility over periods of 20 to 30 years will encompass the greatest percentage of both fundamental, qualitative risks and short-term price volatility. Asset classes and individual investments must be measured over long time periods to attempt to encompass all the various risk factors.

The Board will measure risk by both volatility and fundamental factors.

TOTAL FUND RISK OBJECTIVES

Standard Deviation Risk

A standard deviation of investment returns over a rolling 5-year period no greater than the Fund's passive benchmark portfolio.

Liquidity Risk

No more than 25% of the Fund shall be invested in instruments which are not regularly publicly traded on a daily basis.

Maximum Investment

No more than 2.5% of the Fund may be invested in any one security, with the exception of United States Treasury or Agency Obligations, a commingled fund or mutual fund, or a total return swap for an index or other derivative used to replicate an asset class exposure.

ASSET ALLOCATION

The decision of how to distribute the Fund assets among broad asset categories of domestic and international equities, private equity, domestic and international fixed income, real estate, hedge funds and opportunities is based upon a number of factors including, but not limited to:

- Financial condition of the Fund
- Expected long-term capital market outlook
- Participant growth
- SCERS' risk tolerance
- Cash flow requirements
- Actuarial requirements

SCERS has assumed the following long-term capital market returns for the asset allocation model. These assumptions are based on historical long term returns, the forecast economic environment and recommendations from SCERS' External Investment Consultant, Independent Actuary, and Chief Investment Officer.

EXPECTED CAPITAL MARKET RETURNS

ASSUMPTIONS: 10 Year Horizon, 2.5% Inflation

Asset Class	Real Rate of Return	Total Return	Expected Risk
Domestic Equity	5.7%	8.2%	18.6%
Domestic Long/Short Hedge Fund	5.7%	8.2%	15.1%
International Equity	5.7%	8.2%	19.5%
Private Equity	7.0%	9.5%	28.4%
Domestic Fixed Income	2.8%	5.3%	5.5%
Real Estate	4.7%	7.2%	13.7%
Opportunities Portfolio	2.0%	4.5%	18.0%
Cash	1.2%	3.7%	1.3%

These factors establish the basis for SCERS' long-term strategic asset allocation targets and ranges. Importantly, the long-term strategy includes ranges for each asset category in order to take advantage of market opportunities. The aggregate of the investments in each asset class is intended to match the characteristics of the returns used in the asset allocation model. Deviations from the characteristics represent strategic shifts to add value over these returns.

ASSET DIVERSIFICATION

Based upon the SCERS' capital market assumptions and those factors outlined by the Policy Statement, the Board retains an external investment consultant to create an asset allocation model. Based upon the performance objectives and risk constraints, the current SCERS' Asset Allocation Policy is:

SCERS' ASSET ALLOCATION POLICY

ASSET CLASS	TARGET	RANGE	
		MINIMUM	MAXIMUM
DOMESTIC EQUITY	30.0%	27.0%	33.0%
CORE Index	10.0%	9.0%	11.0%
CORE Enhanced Index	3.0%	2.4%	3.6%
CORE Active Short Extension	3.0%	2.4%	3.6%
Value	7.0%	6.3%	7.7%
Large	4.0%	3.2%	4.8%
Small	3.0%	2.4%	.3.6%
Growth	7.0%	6.3%	7.7%
Large	4.0%	3.2%	4.8%
Small	3.0%	2.4%	3.6%
LONG/SHORT HEDGE FUND	5.0%	4.5%	5.5%
PRIVATE EQUITY	5.0%	4.5%	5.5%
INTERNATIONAL EQUITY	20.0%	18.0%	22.0%
MSCI EAFE Developed Markets	13.0%	11.7%	14.3%
Small Cap S&P/Citibank EMI Index	2.0%	1.6%	2.4%
Emerging Markets	5.0%	4.0%	6.0%
FIXED INCOME	20.0%	18.0%	22.0%
Enhanced Index	6.7%	6.0%	7.4%
Active Core Plus	13.3%	12.0%	14.6%
REAL ESTATE	15.0%	13.5%	16.5%
Private Market Core	9.0%	7.2%	10.8%
Private Market Value Added	3.0%	1.5%	4.5%
Public Equity Real Estate Securities	3.0%	1.5%	4.5%
OPPORTUNITIES	5.0%	4.5%	5.5%
CASH	0.0%	0.0%	2.0%

The range for each asset class is set to provide strict adherence to the asset allocation policy within optimum variances. The range for each individual style is wider because of the normal volatility within any given asset class. The maximum and minimum ranges do not add up to the maximum and minimum for the asset class because of the wider ranges for each style. Maintaining the assets within the asset class ranges is critical to the Fund's ability to meet its performance objectives.

PERMISSIBLE INVESTMENTS

Listed below are the investment vehicles specifically permitted under this Statement of Investment Policy and Objectives for separately managed accounts. They are categorized as equity, fixed income, real estate and derivatives to indicate how they are classified for purposes of the asset class structure guidelines in the following section. Unless given authorization in writing, managers are allowed to invest only in the investment vehicles listed below for the asset class for which they have been hired.

Equities

Investments include publicly-traded common stocks, preferred stocks, covered stock option calls, equity securities of foreign companies traded on registered U.S. stock exchanges, NASDAQ, or non-US stock exchanges and convertible securities (preferred or corporate bonds) and private equity funds, and private equity funds of funds.

Fixed Income

Investments include the full universe of fixed income instruments within different sectors of the U.S. and international bond markets including US government and agency debt, Treasury Inflation-Protected Securities, corporate debt instruments, mortgage and other asset-backed securities, municipal debt, high yield bonds, convertible debentures, certificates of deposit, non-dollar debt securities and fixed income mutual funds consisting primarily of the permissible investments. Also included in fixed income are privately placed debt instruments, and debt funds and funds of funds.

Real Estate

Investments include private market participation in commercial, industrial and residential real estate properties. These investments may comprise both open end commingled funds, closed end commingled funds and separate direct ownership accounts. Investments may also include publicly traded real estate equity securities including issues of Real Estate Investment Trusts (REIT) or Real Estate Operating Companies (REOC).

Derivatives

Investment managers may be permitted through individual investment guidelines to use derivative instruments to control or manage portfolio risk. Derivatives are contracts or securities whose returns are derived from the returns of other securities, indices or derivatives. This definition includes collateralized mortgage obligations, futures, forwards, options, options on futures, swaps and swaptions. Managers may not utilize derivatives for speculative purposes. In no circumstances can derivatives lever any positions in SCERS portfolio, except as expressly authorized in writing. No derivatives positions can be established that create portfolio characteristics outside of current portfolio guidelines. Examples of appropriate applications of derivative strategies include hedging interest rate and currency risk, and maintaining exposure to a desired asset class while effecting asset allocation changes.

Other Financial Instruments

Other financial instruments include investments in currency, currency derivatives, commodities and commodities futures as permitted in individual investment manager guidelines.

ASSET CLASS STRUCTURE AND STYLE

DOMESTIC EQUITIES

33.3% Passive Management / 66.7% Active Management

SCERS' domestic equities emphasize broad security and style diversification. The portfolio is equally weighted between the Value and Growth style. The aggregate portfolio will be designed to be neutral in capitalization and style to the characteristics utilized by the Asset Allocation Model. The goal of the active managers is to outperform their respective market segments and as a group exceed the passive benchmark portfolio.

U.S. Equity Benchmark Index --The Russell 3000 Index tracks the 3000 largest U.S. equities. This segment is a broad passive index of publicly traded stocks representing 98% of the investable U.S. equity market.

Growth Stocks --This segment is characterized by higher risk, lower yield, and higher P/E ratios. Growth stock portfolios display above-market performance in rising markets. Over the course of a market cycle, the active managers will exceed the return of their passive segment of the market. Smaller capitalized stocks will exhibit even higher rates of return. The growth stocks are divided into 57.1% large to mid cap and 42.9% small capitalization companies.

Value/Defensive --This segment attempts to outperform the market in down and flat markets, while obtaining market or lagging market performance in "up" markets. Over the course of a market cycle the active managers will exceed the return of their passive segment of the market. Value/defensive portfolios are usually characterized by Price to Book ratios and P/E ratios below the Russell 1000 Index for large cap stocks and below the Russell 2000 Index for small cap stocks and by dividend yields above the Russell 1000 Index for large cap stocks and above the Russell 2000 Index for small cap stocks. The value stocks are divided into 57.1% large to mid cap and 42.9% small capitalization companies.

EQUITY LONG/SHORT HEDGE FUNDS

100% Fund of Hedge Funds

This category of investment is intended to diversify SCERS domestic equity investment portfolio and improve overall portfolio risk/return characteristics. These investments will be correlated to the domestic equity markets at a ratio of .4 or less and are expected to provide downside protection in negative equity markets. The portfolios will employ strategies with a long bias in the range of 30-50% and with gross leverage of less than 2x at the portfolio level.

PRIVATE EQUITY

100% Active Management

This category of investment includes limited partnerships, funds and funds of funds that invest in domestic and international private venture capital, mezzanine capital, buyouts and distressed debt.

INTERNATIONAL EQUITY

100% Active Management

This category emphasizes diversification, seeking to attain net returns in excess of international index returns, which are not highly correlated to other assets in the portfolio, thereby reducing the SCERS' overall risk. The exposure to emerging markets creates added return and diversification from other assets increasing expected investment return and reducing risk.

International Equity Benchmark Indexes -- SCERS' utilizes the Morgan Stanley EAFE Indices for developed countries and the MSCI EMF Index for emerging markets. The emerging markets are 25% of the international equity allocation.

Active International Equity --These investments will be allocated between the regions, countries, developed markets and emerging markets consistent with the managers' assignment. The determination of the allocations is at the discretion of the managers but regional weightings should vary no more than 20% from the Benchmark weights. Managers can actively hedge the currency exposure at any time.

FIXED INCOME

33.3% Enhanced Index Management / 66.7% Active Core Plus Management

This category includes actively managed investments in U.S. treasury and agency securities, corporate bonds, mortgage-backed and asset-backed securities, non-dollar denominated sovereign debt and corporate debt and fixed income derivatives. The active portion is split between two core managers, to provide an asset class duration similar to the benchmark index. The use of a twenty percent or less exposure to Non-Dollar bonds and high yield debt increases the expected return and the diversification of the portfolio.

Risk Control - The aggregate fixed income portfolio will have a duration which is +/- 20% of the duration of the Fixed Income Index, and an average minimum credit quality of A-, as determined by a major rating agency, with a return in excess of the index used by the Asset Allocation Model.

Fixed Income Enhanced Index - The Barclays Capital Aggregate Bond Index, which represents a broad passive holding of all segments of rated U.S. fixed income is enhanced by varying the portfolio characteristics for duration, allocation to sectors and credit quality of the holdings in comparison to the benchmark.

Active Core Plus Fixed Income - The active Core core plus will have a duration that will range within 50% plus or minus the duration of the index. Also, the portfolio will have a minimum average credit quality of A/A. The active core plus portfolio can invest up to 20% un-hedged in Non-Dollar bonds and 20% in high yield or below investment grade debt.

REAL ESTATE

100% Active Management

This segment is intended to provide diversification from SCERS' holdings in equities and fixed income. Some of these investments are not marked to market each day and are not highly correlated to any of the other assets in the portfolio. In addition, some of these investments are very illiquid in nature. As such, the Board will establish a limit on the total allocation to the asset class. A portion of these investments are privately placed and their value is based upon an independent evaluation at regular intervals until actually sold.

Real Estate Private Market -- The majority of the real estate allocation will be held in private placements, which entail equity participation in commercial, residential and industrial real estate properties. These investments may comprise both open end commingled funds, closed end commingled funds and separate direct ownership accounts. The NCREIF Property Index represents real estate owned by tax-exempt institutions and held in a fiduciary environment and will be the index against which manager performance is measured.

Real Estate Public Equity Securities -- A portion of the portfolio will be invested in issues of Real Estate Investment Trusts (REIT) or Real Estate Operating Companies (REOC) managed by an experienced real estate securities investment manager. Only equity REIT securities and REOC securities which are broadly classified as institutional quality issues are eligible for inclusion in the portfolio. All securities held in the portfolio should be publicly traded and have sufficient marketability to permit prompt, orderly liquidation under normal circumstances. The NAREIT Equity Index will be the benchmark against which manager performance is measured.

OPPORTUNITIES

This segment includes a mix of investment securities that offer good risk/adjusted investment returns and are expected to have a low correlation with SCERS' public equity and debt investments. Investments which may be included in this asset class are commodities and commodity futures, Treasury Inflation Protected Securities (TIPS), timber or agriculture land, real return strategies, direct private equity, debt securities and other unique strategies. Investments will be assigned to this asset class based on the recommendation of the CIO and the Investment Consultant.

STRATEGIC OVERLAY

This investment strategy utilizes SCERS available cash to replicate the target asset allocation on a periodic basis for the purpose of assuring compliance with SCERS' Asset Allocation, excluding the real estate asset class. In addition, at least monthly, the Manager will overlay a replication of SCERS' Asset Allocation to rebalance the total portfolio, utilizing the Permissible Investment or other investments authorized in writing in the Manager's investment management guidelines.

The strategy is expected to reduce the drag of excess cash on total portfolio investment return and to reduce tracking error with SCERS Asset Allocation. The performance objective is to provide 10-25 basis points in annualized return to the SCERS Portfolio.

IMPLEMENTATION

IMPLEMENTATION OBJECTIVES

The CIO will establish procedures to ensure consistent operational compliance with Board policies and the efficient handling of investment duties.

PERIODIC REVIEW OF ASSET ALLOCATION POLICY

With the input from the Investment Consultant and the Actuary, SCERS will review the appropriateness of its asset allocation targets and ranges in light of changes in SCERS' liabilities and general market conditions. Such review, including an updated projection of assets and liabilities, shall be conducted at least every five years. The Chief Investment Officer will review the actual versus target Asset Allocation each quarter and provide a report to the Board indicating differences.

REBALANCING THE ASSET ALLOCATION

The Strategic Overlay Manager (Manager) under the supervision of the Chief Investment Officer will monitor the overall asset allocation to assure compliance with the target exposure to the asset classes and related target weights as defined by the SCERS' Asset Allocation, excluding the real estate asset class. At least monthly the Manager will overlay a replication of SCERS' Asset Allocation target exposure to the asset classes and related target weights utilizing the permissible investments approved in the Manager's investment management guidelines and objectives for the strategic overlay assignment.

The CIO will re-balance the asset allocation to the target ranges at least annually or at any time the allocations go outside the minimum and maximum ranges on page nine (9). Income and dividends are withdrawn from the Investment Managers' accounts each quarter except for trusts, commingled funds and public real estate portfolios. This cash flow and the net contribution cash flow will be used first to adjust the asset allocation. Any additional re-balancing required will be accomplished by shifting assets from one asset class to another. The CIO will consider transaction costs and the illiquidity of some asset classes when making the re-balancing decision. Given the volatility of the capital markets, constant minor adjustments will be avoided to reduce excessive turnover and transaction costs. The goal will be to re-balance to each asset allocation target when actual allocations are outside the policy range. Any re-allocation of assets between asset classes will be reported to the Board as part of the quarterly asset allocation report.

The Board has established certain style balances and risk controls within each asset class. The CIO will monitor the structure within each asset class to maintain the intended structure. The CIO, in consultation with the Investment Consultant, will shift assets between investment managers within an asset class to maintain the Board directed style balances and risk controls. After any transfer between investment managers, the Chief Investment Officer will notify the Board at its next available meeting.

The procedure for rebalancing is outlined below:

At least annually or when the asset allocation is outside the policy target range the CIO will, in consultation with the Strategic Overlay Manager:

1. Rebalance each Asset Class, which exceeds or is below the range.
2. Fully allocate the balance of uncommitted cash.
3. Utilize the Fund's cash flow as the first source of funds for re-balancing.
4. The final source will be shifts among asset classes.

At least semi-annually the Chief Investment Officer, in consultation with the Strategic Overlay Manager, will review the allocation of assets to individual investment managers and if determined to be necessary will:

1. Rebalance within each asset class to the Board approved style tilts and risk controls.
2. Rebalance any individual Investment Manager that exceeds their range.
3. Report any shift of assets between investment managers to the Board at its next meeting.

INVESTMENT MANAGER AGREEMENTS

SCERS will use SCERS' standard investment management agreements, unless business practice requires a specialized contractual agreement. The manager will be a Registered Investment Advisor under the 1940 Investment Act, unless exempt from registration as a bank, and must agree to be a fiduciary. The contract will detail the fee schedule, the investment guidelines and the portfolio restrictions.

INVESTMENT COST CONTROL

Annually the CIO shall present to the Board a review all the investment costs of SCERS.

INVESTMENT MANAGER REPORTING

To assist SCERS in maintaining adequate and accurate accounting for the assets of the fund, and to provide for the monitoring of investment managers' portfolios for compliance with investment guidelines and restrictions, the managers will be required to reconcile their investment holdings, transaction activity and income with SCERS' custodian bank on a monthly basis. Such reconciliation shall be provided to the custodian and SCERS in writing and be prepared in accordance with SCERS' standard reporting format. Any change in the report format will be provided to the manager in writing before being implemented

PERFORMANCE REVIEW

The CIO, with assistance from the external investment consultant, will prepare an investment performance report to the Board on a quarterly basis. Performance will be measured for the total portfolio and individual components including equities, hedge funds, fixed income, real estate and opportunities portfolios, as set forth on page six (6). In addition, the performance of each component will be broken down into individual portfolios, as set forth on pages twenty (20) and twenty-one (21).

Comparisons will be made against market indices defined in this document. A variance from the stated performance objective will be calculated each quarter. Additionally, each individual portfolio's actual investments will be monitored against its assigned investment style to determine whether the investment manager is adhering to it.

The quarterly investment performance report will compare the total fund, each asset class and individual portfolio return to appropriate market indices and a representative peer group of similar funds or similar style investment managers. The report will note significant changes in the attribution of investment manager performance.

Every six months, the CIO with the assistance of the investment consultant will provide the Board with a review of one of the four major asset categories of the total investment portfolio in detail. Therefore, during a two-year period the CIO and the investment consultant will conduct a detailed review of each of the four asset categories in which SCERS' invests.

INVESTMENT ACTIVITY COMPLIANCE AND INVESTMENT MANAGER MONITORING

Individual investment managers will be continually monitored on performance and adherence to the firm's philosophy, process, style, and the terms and conditions of the investment management agreement. In addition, the investment managers' organization and operations will be qualitatively monitored on a continual basis.

The CIO will prepare a monthly investment activity and compliance report. The report will note individual investment manager statistical compliance to their investment guidelines, objectives and portfolio restrictions. The CIO will review the investment manager purchases and sales for each month, and note in the report any deviations from the investment guidelines and restrictions, as outlined by the investment manager agreement, or significant changes in:

- | | |
|--|---|
| <input type="checkbox"/> portfolio composition | <input type="checkbox"/> sector weights |
| <input type="checkbox"/> portfolio turnover | <input type="checkbox"/> general trading activity |
| <input type="checkbox"/> changes in market value | <input type="checkbox"/> changes in cash position |

Quarterly, the CIO will review the performance characteristics and the dispersion of the investment managers' returns within the investment style and the portfolio managers. Annually, the CIO will request and review the Investment Manager ADV Part II form and inform the Board of significant changes in the firm or apparent conflicts of interest.

INVESTMENT MANAGER WATCH LIST

The Board has delegated the ongoing monitoring of investment manager performance and the contractual relationship to the CIO and the Investment Consultant. From time to time, when in the opinion of the CIO's and Investment Consultant a significant or material adverse event occurs, an Investment Manager will be placed on a "Watch List".

Reasons for an investment manager to be placed on the "Watch List" include:

- Persistent underperformance of specified benchmarks or peer groups;
- a significant change in the firm's ownership and/or structure;
- loss of one or more key personnel;
- significant loss of assets under management and loss of clients;
- shifts in the firm's investment philosophy or process;
- persistent lack of responsiveness to SCERS requests;
- regulatory investigations;
- recurring violations of the Investment Policy, investment guidelines or instructions;
- any other issue or situation of which the staff, investment consultant and/or Board become aware this deemed material.

If an investment manager is placed on the "Watch List" the CIO will notify the investment manager in writing that it has been placed on the "Watch List", an explanation of the adverse event resulting in the placement of the investment manager on the "Watch List" and informing the investment manager of what the investment manager needs to do to be removed from the "Watch List".

The placement of an Investment Manager on the "Watch List" will be reported to the Board at the next regular Board meeting along with an explanation of the adverse event resulting in the placement of the investment manager on the "Watch List", conditions needing to be met or improvement required to remove a investment manager from the "Watch List" and an indication of the length of time for the conditions to be met or improvement to occur for the "Watch List" status to be removed or for consideration that a investment manager be terminated.

At least quarterly, and whenever the Board deems it appropriate, the CIO and the Investment Consultant will prepare a report to the Board on the investment manager's on the "Watch List" and the progress being made on improving performance or correcting other non-performance related concerns. The report will include a recommendation by the CIO and the Investment Consultant on whether the investment manager should be removed from the "Watch List", continue on the "Watch List" or be terminated.

By being placed on the "Watch List", the investment manager will be under close review by the CIO, the investment consultant and the Board. The purpose of the "Watch List" is to formally notify the investment manager of SCERS' concerns. The CIO and the investment consultant will contact the investment manager to address the events resulting in the investment manager's being place on the "Watch List" and the CIO and the investment consultant may require the investment manager to meet with them or visit the investment manager's offices. The Board may request the investment manager appear in person before the Board before acting on a recommendation from the CIO and investment consultant for an investment manager to be terminated.

Performance

Investment manager performance is measured against their respective portfolio benchmark and relative to a peer group of similar style investment managers. Over any rolling three year and five year periods the investment manager is expected to generate an annualized net return in excess of the portfolio benchmark and rank in the top 40th percentile for their style peer group. Significant deviations from the performance objective, even over shorter time periods, will place the investment manager under closer observation, called the “Watch List”.

When an investment manager’s annualized portfolio investment performance for two consecutive quarters for trailing three year and five year periods is below the investment manager’s portfolio benchmark and the investment manager’s ranking is below the 40th percentile for a peer group of similar style investment managers the investment manager will be placed on the “Watch List”. The portfolio performance benchmarks are included at the end of the Investment Policy and Objectives in the table entitled Performance Objectives for Individual Portfolio Components and is included in the attached amendment.

An investment manager may also be placed on the “Watch List” for poor performance over shorter time periods. If an investment manager’s portfolio performance for the trailing one year period is more than twenty-five percent below the portfolio benchmark (.25 x the portfolio return) and the investment manager’s peer ranking is below the 75th percentile for two consecutive quarters the investment manager will be placed on the “Watch List”.

Investment manager investment performance is expected to improve within twelve to eighteen months from the time of being placed on the “Watch List”. The CIO and the Investment Consultant will make a recommendation on removing the investment manager from the “Watch List”, continuing the “Watch List” status or termination at least once each quarter from the date the investment manager is first placed on the “Watch List”.

Non-Performance Events

Significant gains or losses of key personnel, assets under management, or clients, non-responsive communication, changes in ownership structure, among other factors, may place the investment manager on the “Watch List”. These changes are subjective in nature and will require a review by the CIO and the Investment Consultant and a written report being made to the Board. If any change is found to significantly impact or impair SCERS’ objectives, the Investment manager may be immediately terminated by the Board on the recommendation of the CIO and the Investment Consultant. The termination of an investment manager shall be carried out in accordance with the process and procedure set out below.

A “Watch List” designation resulting from a non-performance event should be addressed and any conditions met within six to nine months.

INVESTMENT MANAGER TERMINATION

SCERS may immediately terminate a manager for any reason without prior notice. In most cases any action to terminate a manager should be taken by the Board upon the recommendation for termination of the CEO or the CIO, with the concurrence of the investment consultant.

If the CEO, with the concurrence of the Board President, determines that in order to protect the assets of the Retirement Fund immediate or emergency action by the Board is required the SCERS' Board President shall call a Special Board meeting. The Special Board meeting shall be called in compliance with legal requirements governing open meetings and notice requirements.

If the CEO and the CIO, or one such officer if the second is unavailable, determine, in consultation with the investment consultant and the General Counsel, and with the concurrence of the Board President or one or more Vice-Presidents if the President is not available, that: (1) it is necessary to immediately terminate an investment manager in order to protect the assets under the control of the investment manager; (2) it is not feasible to convene a meeting of the Retirement Board for that purpose in a timely manner; and (3) delay could result in detrimental impact to SCERS' assets or interests, the CEO or the CIO may terminate the agreement with the investment manager. The CEO or the CIO shall immediately report such termination to the Board, along with a report of the circumstances that prompted such action.

Whenever the CEO or the CIO exercise the authority to terminate an agreement with an investment manager as provided above, he or she may also take whatever actions he or she may determine, in consultation with the investment consultant and the General Counsel, and with the concurrence of the Board President or one or more Vice-Presidents if the President is not available, are reasonable and necessary to transition the assets under the control of the investment manager to alternate management, including, without limitation: (1) temporarily assigning the assets to another existing contracted investment manager; (2) identifying and engaging an alternate investment manager to manage the assets until a permanent replacement for the terminated manager can be engaged; or (3) contracting for the services of a transition manager to facilitate an efficient and cost effective transition of the assets between the former and interim manager. The CEO, or in his or her absence, the CIO, may execute any and all agreements reasonably necessary to facilitate an orderly and efficient transition of the affected assets, so that they will be managed and protected until they are assigned to one or more alternate investment managers as determined by the Board. The CEO, or in his or her absence the CIO, shall immediately report any and all steps taken to transition the assets and to protect the interests of SCERS to the Board.

DELEGATION OF AUTHORITY TO MODIFY EXISTING INVESTMENTS

The Members of the Board have a fiduciary responsibility to manage the investment of the assets of the Retirement Funds with the care, skill, prudence and diligence under the circumstances prevailing that a prudent person acting in a like capacity would use. In most cases, any action to modify the terms and conditions of an existing investment should be taken by the Board itself upon recommendation of the CEO or CIO, with the concurrence of the investment consultant. However, changes in prevailing circumstances may require that a prudent person act more quickly than the Board could act to modify the terms and conditions of an existing investment of assets in order to protect the assets. In those circumstances the Board has determined that it may be prudent, reasonable and necessary to delegate authority to take action to modify an existing investment as provided below.

If the CEO, with the concurrence of the Board President, or a Vice-President if the President is not available, determines that to protect the assets of the Retirement Funds emergency action is required to modify the terms and conditions of an existing investment between regular Board meetings, the SCERS' Board President or Vice-President shall call a Special Board meeting, in compliance with legal requirements governing open meetings and notice requirements. However, if the CEO and CIO, or one such officer if the second is unavailable, determine in consultation with the investment consultant and the General Counsel, and with the concurrence of the Board President or one or more Vice-

Presidents if the President is unavailable, that it would not be prudent and feasible to call a Special Board meeting because immediate action is required, and that delay could result in detrimental impact to SCERS' assets or interests, the CEO and the CIO, or one such officer if the second is unavailable, may immediately take any action deemed to be prudent, reasonable and necessary to best protect SCERS' assets or interests, including but not limited to, modification of the terms and conditions of an existing investment in compliance with the following procedures:

- 1. As to any Modification of an Investment Involving No More Than Two Percent of the Market Value of the Retirement Fund**
 - a. Any action may only be taken with the concurrence of the President, or a Vice-President if the President is not available.
 - b. The CEO or CIO shall immediately report the action to the Board, along with a report of the circumstances that prompted such action.
- 2. As to any Modification of an Investment Involving More than Two Percent of the Market Value of the Retirement Fund**
 - a. Any action may only be taken with the concurrence of a majority of the President and the two Vice-Presidents, or any other combination of Trustees that may be designated by the Board for that purpose, provided that any combination must consist of less than a majority of the Board.
 - b. The CEO or CIO shall immediately report the action to the Board, along with a report of the circumstances that prompted the action and the required concurrence of the designated Trustees.

The CEO, or in his or her absence, the CIO, may execute any and all agreements and documents on behalf of SCERS as may be reasonably necessary to implement any modification of an existing investment as authorized above.

PERFORMANCE OBJECTIVES FOR INDIVIDUAL PORTFOLIO COMPONENTS

DOMESTIC EQUITY (80% large to mid and 20% small)

Large Cap Core Index - (33.3%)	Return equal to Russell 1000 Index or other comparable index, net of fees.
Enhanced Index - (10.0%)	Return equal to Russell 1000 Index, or other comparable index plus .50%, net of fees.
Large Cap Short Extension - (10.0%)	Return equal to Russell 1000 Index, or other comparable index plus 1%, net of fees.
Large Cap – Growth - (13.3%)	Return equal to Russell 1000 Growth Index or other comparable index plus 1%, net of fees.
Small Cap – Growth - (10.0%)	Return equal to Russell 2000 Growth Index or other comparable index plus 1.5%, net of fees.
Large Cap – Value - (13.3%)	Return equal to Russell 1000 Value Index or other comparable index plus 1%, net of fees.
Small Cap –Value - (10.0%)	Return equal to Russell 2000 Value Index or other comparable index plus 1.5%, net of fees.

INTERNATIONAL EQUITY (75% Developed and 25% Emerging Markets)

Developed Markets - (86.7% large 13.3% small)	
Large - Value - (20.0%)	Return equal to MSCI EAFE Value Index plus 1%, net of fees.
Large - Core - (25.0%)	Return Equal to MSCI EAFE Index plus 1%, net of fees.
Large – Growth – (20.0%)	Return equal to MSCI EAFE Growth Index plus 1%, net of fees.
Small Cap – (10.0%)	Return equal to MSCI EAFE Small Cap Index or other comparable index plus 1.5%, net of fees.
Emerging Markets - (25.0%)	
Emerging Markets Growth	Return equal to the MSCI EMF Index plus 1.5%, net of fees.

(Manager Objectives Continued on the next page)

PERFORMANCE OBJECTIVES FOR INDIVIDUAL PORTFOLIO COMPONENTS (continued)

PRIVATE EQUITY

100% of the asset class is allocated to private equity managers

Return is equal to S&P 500 plus 200 basis points, net of fees.

FIXED INCOME

Enhanced Index - (33.3%)
Enhanced Lehman Aggregate

Return equal to Barclays Capital Aggregate Bond Index plus 0.25%, net of fees.

Active Core Plus - (66.7%)

Return equal to Barclays Capital Aggregate Bond Index plus 0.7%, net of fees.

REAL ESTATE

Private Market - (80% of asset class)
Core Funds or Separate Accounts

Return equal to the NCREIF plus 1.0%, net of fees.

Value Added Funds

Return equal to the NCREIF plus 2.0%, net of fees.

Public Equity – (20% of asset class)
Separate Accounts

Return equal to the NAREIT plus 1.0%, net of fees.

EQUITY LONG/SHORT HEDGE FUNDS

100% of the asset class is allocated to equity long/short fund of funds managers

Return is equal to the annualized 91-day T-Bill Rate plus 5.0%, net of fees.

OPPORTUNITIES

This segment includes a mix of investments that offer good risk/adjusted returns and have a low correlation with SCERS' public equity and debt investments, such as commodities

Return is equal to Dow Jones UBS Commodities Index plus 100 basis points, net of fees.

STRATEGIC CASH OVERLAY

Daily available cash is to be invested permissible investments as authorized by this Policy excluding real estate.

Passive Return of SCERS' Asset Allocation, excluding the real estate class.

