

March 20, 2024

Watch List Education

Santa Barbara County Employees' Retirement System



Introduction

What Watch Lists Are

- Watch Lists are designed as a monitoring and decision supporting tool, typically employing both quantitative and qualitative information.
- The goal of a Watch List is to systematically draw attention to investment managers that are experiencing, or are expected to experience, challenges (e.g. performance or organization related).

What Watch Lists Are Not

- Watch Lists are not designed to serve as “decision triggers” or “action lists,” as even managers that have delivered strong long-term results experience periods of underperformance.
- Instead, “On Watch” managers should be reviewed periodically to determine if the Board and RVK maintain conviction in their investment process, as well as the stability of the investment team and firm.

Placing a Manager on the Watch List

SBCERS' Investment Policy prescribes both quantitative and qualitative factors to merit a manager's placement on the Watch List.

Quantitative

- Test 1: The investment manager's rolling 5-year return (net of fees) falls below the rolling 5-year benchmark return for 3 consecutive quarters.
- Test 2: The investment manager's rolling 5-year return (net of fees) ranks in the bottom third of the General Investment Consultant's peer group universe for 3 consecutive quarters.

Qualitative

- An investment manager may be added to the Watch List should a significant and potentially adverse event take place.
- Examples include, but are not limited to, a violation of investment guidelines, significant deviation from stated investment style, turnover of one or more key personnel, a change in firm ownership or structure, the initiation of significant litigation or regulatory action, etc.

SBCERS Manager Watch List

RVK maintains the Watch List and reports each active managers' compliance with both quantitative and qualitative criteria on a quarterly basis.

Quantitative Criteria

Test 1: If the Manager's rolling, five-year return (net of fees) falls below the rolling, five-year benchmark return for three (3) consecutive quarters.

Test 2: If the Manager's rolling, five-year return (net of fees) for three (3) consecutive quarters ranks in the bottom third of the General Consultant's peer group universe.

Qualitative Criteria

Asset Class	Investment Manager	Inception Date	✓ indicates failed test			Watch List Status	✓ indicates failed test			Watch List Status	Qualitative Factor(s) Resulting in Watch List Addition											Benchmark	Peer Group					
			2023 Q2	2023 Q3	2023 Q4		2023 Q2	2023 Q3	2023 Q4		A	B	C	D	E	F	G	H	I	J	Explanation							
U.S. Equity	Dimensional U.S. Small Cap Value (CF)	4/1/2005																								Russell 2000 Index	U.S. Small Cap Value Equity	
	RHJ Small Cap Opportunities (SA)	6/1/2016				On Watch (2023 Q2)				On Watch (2023 Q2)																Russell 2000 Index	U.S. Small Cap Growth Equity	
Developed Market non-U.S. Equity	PanAgora Dynamic International Equity (SA)	5/1/2009																									MSCI EAFE Index (USD) (Net)	EAFE Core
	Artisan Non-U.S. Growth (SA)	2/1/2014				On Watch (2023 Q4)				On Watch (2023 Q4)																	MSCI EAFE Index (USD) (Net)	EAFE Growth
	Acadian Non-US Small Cap Equity (CF)	12/1/2020				N/A (Insufficient Performance History)				N/A (Insufficient Performance History)																	MSCI EAFE Sm Cap Index (USD) (Net)	International Small Cap Equity
Emerging Markets Equity	DFA Emg Mkts Value;I (DFEVX)	5/1/2013																									MSCI Emg Mkts Index (USD) (Net)	Emerging Markets Equity
	RBC Emerging Markets Equity (CF)	9/1/2016																									MSCI Emg Mkts Index (USD) (Net)	Emerging Markets Equity
Core Fixed Income	Garcia Hamilton Core Fixed Income (SA)	9/1/2017																									Bloomberg US Agg Bond Index	U.S. Broad Market Core Fixed Income
	PGIM Core Plus Fixed Income (CF)	6/1/2018																									Bloomberg US Agg Bond Index	U.S. Broad Market Core+ Fixed Income
Non-Core Fixed Income	Wellington Blended Opportunistic EMD (CF)	4/1/2020				N/A (Insufficient Performance History)				N/A (Insufficient Performance History)																	Wellington Blended Benchmark	Emerging Markets Debt
	Beach Point Leveraged Loan (CF)	10/1/2012																									CS Lvg'd Loan Index	U.S. Bank Loans
Real Return	Cohen & Steers Real Assets Fund (CIT)	9/1/2017								N/A (No Comparable Universe)																	Cohen & Steers Real Assets Custom Index	N/A
	Nuveen Real Asset Income Fund (SA)	9/1/2017								N/A (No Comparable Universe)																	Nuveen Real Asset Income Blend Index	N/A

SBCERS History of Managers “On Watch”

- Below is a history of SBCERS’ managers placed “On Watch” since 2016.
- Many managers who failed the quantitative watch criteria were able to rebound and subsequently were removed from watch status.
- However, there have been instances when “On Watch” managers end up being terminated for performance concerns or other reasons.

Manager	Placed On Watch	Reason for Watch Status	Resolution
Stone Harbor	2018 Q1	Failed quantitative criteria	Terminated as a result of RFP
Copper Rock	2020 Q1	Failed quantitative criteria	Terminated as a result of RFP
DFA – EM Value Equity	2020 Q3	Failed quantitative criteria	Removed from Watch - 2022 Q3
DFA – US SCV Equity	2020 Q3	Failed quantitative criteria	Removed from Watch - 2021 Q3
PanAgora	2022 Q1	Failed quantitative criteria	Removed from Watch - 2023 Q1
Rice Hall James	2023 Q2	Failed quantitative criteria	Terminated as a result of structure study
Artisan	2023 Q4	Failed quantitative criteria	On Watch - monitoring

Case Study #1: Copper Rock

- Copper Rock was hired in 2013 to manage an International Small Cap Equity mandate. As of March 31, 2020, Copper Rock failed both quantitative watch list criteria tests and was placed “On Watch”.
- During the June 2020 Board meeting, RVK presented an Equity Structure Review in which RVK advised the Board that we would further evaluate the International Small Cap Equity exposure managed by Copper Rock.
- An RFP for International Small Cap Equity managers was issued on July 29, 2020. The RFP received a strong response with 17 prospective firms submitting bids alongside the incumbent, Copper Rock.
- Copper Rock was eliminated from consideration in the finalist round of the RFP. At the time, they were in the process of making portfolio management leadership changes in the coming year. The firm had also lost a significant amount of their assets under management and had poor historical performance relative to other finalists.
- **Outcome: RVK and SBCERS Staff recommended and the Board unanimously agreed to fire Copper Rock and hire Acadian to manage the International Small Cap Equity mandate. This transition occurred in November of 2020.**

Case Study #2: DFA EM Value Equity

- DFA was hired in 2013 to manage an Emerging Markets Equity mandate. As of September 30, 2020, DFA failed both quantitative watch list criteria tests and was placed “On Watch”.
- At the December 2020 Board meeting, RVK recommended that the Board maintain their investment in the DFA Emerging Markets Value strategy and communicated that RVK would continue to closely monitor SBCERS’ investments with DFA and would communicate any material updates to the Board and Staff.
- At the time, value and small cap factors had been out of favor for an extended period of time, resulting in sustained underperformance relative to the core benchmark.
- DFA remained “On Watch” and was monitored for two years before being removed from watch status as of September 30, 2022.
- **Outcome: DFA continues to manage an Emerging Markets Equity mandate for SBCERS. Performance has rebounded since 2020 and continues to be strong. For the five-year period ending December 31, 2023, DFA Emerging Markets Value returned 5.34% and outperformed the MSCI Emerging Markets Index (USD) (Net) by 1.98% on a net of fees annualized basis.**

PORTLAND

BOISE

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