

**STATE COMPENSATION INSURANCE FUND  
INVESTMENT COMMITTEE**

**MINUTES OF OPEN SESSION MEETING**

**November 17, 2016**

The Investment Committee met on November 17, 2016 at the State Fund Corporate Office, 333 Bush Street, 7<sup>th</sup> floor, San Francisco, California.

**AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL**

The meeting was called to order at 11:30 a.m. and the following members were present: Chair Sen. Michael J. Machado (Ret.); Marvin P. Kropke; Jack L. Neureuter; and William M. Zachry.

There was a quorum.

Also present: President and CEO Vernon L. Steiner; General Counsel and Corporate Secretary Margie R. Lariviere; Chief Financial Officer Peter A. Guastamachio; Board Liaison and Assistant Corporate Secretary Hilda B. Padua; and Counsel and Assistant Corporate Secretary Judith D. Sapper.

**AGENDA ITEM 2: ANTITRUST ADMONITION**

Senator Machado called attention to and requested acknowledgment that the Investment Committee members read State Fund's Antitrust Admonition included in each Committee member's meeting materials.

**AGENDA ITEM 3: CONSENT CALENDAR**

**3a. Approval of May 26, 2016; July 19, 2016; and July 27, 2016 Open Meeting Minutes**

**3b. Approval of April 1, 2016 – May 31, 2016 and June 1, 2016 – September 30, 2016 Investment Transactions**

- i. Bond Transactions
- ii. Compliance Report

**3c. Review and Approval of 2017 Investment Committee Meeting Schedule and Location**

**3d. Review and Approval of 2017 Investment Committee Agenda Items**

Sen. Machado asked whether any Board member had any comments on the items on the Consent Calendar of which there were none.

MOTION: Mr. Kropke

SECOND: Mr. Neureuter

To approve the Consent Calendar as presented.

Sen. Machado requested public comment of which there was none. Sen. Machado called for the vote.

YES: 4

NO: 0

Abstain: 0

Motion carried.

#### **AGENDA ITEM 4: MARKET OUTLOOK AND ECONOMIC UPDATE**

Larry Adam, U.S. CIO & Chief Investment Strategist of Deutsche Asset Management provided an update of the 4Q 2016 market outlook. Mr. Adam noted that the current U.S. economy is the most resilient in the world with key indicators of increased withholding tax receipts, low jobless claims, stabilizing Institute for Supply Manufacturing production, and increased new vehicle sales. The banks have been tightening lending standards and there have been less demand for commercial and industrial loans the past two quarters. The U.S. economy is entering the 8<sup>th</sup> year of expansion with predictions the performance in the portfolios will show lower rates of returns; the Federal Reserve (the Fed) will be raising interest rates; earnings growth will be cut in half; and Gross Domestic Product (GDP) growth will slow down. The Fed is expected to have two rate hikes over the next year with one in December 2016 and another by September 2017 while the European Central Bank, Bank of Japan, and Bank of England will have easing policies in 2017.

The downside is the fading effect of the aggressive Central Bank measures on equity prices. Despite cutting interest rates and increasing and expanding quantitative easing, the Trade Weighted Euro and Japanese Yen have rallied 5% and 19% as of September 2016. With limited fiscal flexibility, many European governments have limited ability to use fiscal stimulus to boost their economies due to limitations set by the Maastricht Treaty. As the Federal Reserve continues to normalize the monetary policy, Price-Earnings (P/E) expansion is unlikely. Historically, the S&P 500 tends to peak about nine months after the Fed starts the tightening cycle and after nine months the returns on average are 0.2%. Equity valuations are trading well above their historical average with fixed income yields expensive as they are near record lows.

Within global fixed income, the U.S. budget deficit should continue to shrink through 2017. This should reduce the amount of Treasury issuance in 2016 to its lowest level, about \$325 billion, since 2007 and it will be further reduced to \$225 billion in 2017. This lower issuance coincides with European Central Bank's aggressive monetary policy with foreign investors looking for higher yields. This is reflected in increased inflows into U.S. bonds while funds have moved out of Europe and Japan. This is the second longest bull market in history but as the bull market matures low volatility is likely to reverse. The cyclical sectors in the areas of technology and consumer discretionary benefit from the economic upswing while the defensive sectors of utilities and telecom are negatively affected by the rise in interest rates and less attractive valuations.

In commodities, crude oil was resilient in 3Q 2016, bucking the seasonal trend of the second half of the year decline. As the U.S. production is offline, global demand is expected to exceed supply in 2017 for the first time since 4Q 2013. As the supply/demand imbalance narrows, the price of crude oil is expected to increase modestly to \$55/barrel over the next 12 months. After the Brexit vote, speculative demand for Gold Exchange Traded Funds (ETFs) rose to its highest level since 2013 with fund flows being a key driver in gold's performance. Falling interest rates have also boosted demand for gold but as the Dollar strengthens, gold could come under pressure due to its negative 20 year correlation to the dollar.

#### **AGENDA ITEM 5: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 7, 9 through 12**

Sen. Machado requested public comment on the appropriateness of Closed Session Agenda Items 7, 9 through 12, of which there was none.

### **AGENDA ITEM 6: PUBLIC COMMENT**

Sen. Machado requested other public comment, of which there was none. The Investment Committee immediately convened into Closed Session at 12:25 p.m.

### **AGENDA ITEM 13: CALL TO ORDER AND ROLL CALL**

The meeting was called to order at 1:25 p.m. and the following members were present: Chair Sen. Michael J. Machado (Ret.); Marvin P. Kropke; Jack L. Neureuter; and William M. Zachry.

There was a quorum.

Also present: President and CEO Vernon L. Steiner; General Counsel and Corporate Secretary Margie R. Lariviere; Chief Financial Officer Peter A. Guastamachio; Board Liaison and Assistant Corporate Secretary Hilda B. Padua; and Counsel and Assistant Corporate Secretary Judith D. Sapper.

### **AGENDA ITEM 14: COMMITTEE MEMBER PRESENTATIONS**

Sen. Machado requested presentations from the Committee members, of which there were none.

### **AGENDA ITEM 15: PROPOSALS AND SUGGESTIONS FOR MARCH 2, 2017 AGENDA**

Sen. Machado requested suggestions for agenda items for the March 2, 2017 Investment Committee meeting other than the standing agenda items, of which there were none.

Sen. Machado requested public comment, of which there was none, and he noted that the next Investment Committee meeting is scheduled for March 2, 2017 at the State Fund Vacaville, California Office unless noticed for a new date and time.

### **ADJOURNMENT**

There being no further business before the Investment Committee, the meeting adjourned at 1:30 p.m.

Respectfully submitted,

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Hilda B. Padua  
Board Liaison and Assistant Corporate Secretary