CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
INTRADEPARTMENTAL CORRESPONDENCE

Date: June 6, 2018

To: Retirement Board Members

From: Linda P. Le, Retirement Plan Manager *LL*

Subject: Board Agenda Item No. 5: Discussion of U.S. Large-Cap Growth Equity Mandate; and Possible Action (June 13, 2018, Regular Retirement Board Meeting)

Recommendation

That the Board of Administration (Retirement Board) of the Water and Power Employees' Retirement Plan (Plan) interview and select one of the following four candidates for the Plan's U.S. large-cap growth (LCG) equity mandate:

- Jennison Associates
- Los Angeles Capital Management
- MFS Investment Management
- Voya Investment Management

Summary

At its regular meeting held on November 8, 2017, the Retirement Board approved a request for proposal (RFP) for a U.S. LCG mandate. (Resolution No. 18-38). The Plan released the RFP in January 2018.

In response to the RFP, 30 firms submitted intents to apply and 24 firms ultimately submitted responses. An initial screen eliminated fifteen firms for failing to meet at least one of the required minimum qualifications (RMQs) and a sufficient amount of preferred criteria (PCs).

This review was done concurrently with a quantitative screen that analyzed characteristics such as consistency of three year rolling returns, consistency of calendar year returns, information ratio compared to peer group median, Sharpe ratio compared to peer group median and up capture / down capture ratio.

Following the quantitative review, ten firms were advanced to be reviewed in depth through a standardized RFP scoring process. This process took a deeper look at the following categories and respective weightings for each:

- Firm: 10%
    - Includes but not limited to history of LCG management, significant changes and employee ownership.
- Team: 15%
    - Includes but not limited to average years of industry experience, manager tenure with firm, is the management team responsible for the track record, turnover on the team and stated succession plan.

- Investment Strategy: 15%
  - Includes but not limited to differentiated process, clearly demonstrated philosophy, thorough process description, and appropriate portfolio construction guidelines.

- Risk Control: 15%
  - Includes but not limited to strength of risk control tools and systems, clearly defined risk management philosophy, and ability to deal with a liquidity event.

- Performance / Quantitative Characteristics: 15%
  - Includes but not limited to portfolio turnover, percentage of cash, trailing period returns relative to benchmark, and information ratio.

- Fees: 10%

- Legal, Compliance & Trading: 10%
  - Includes but not limited to in house compliance, enforcement of code of ethics, and clearly demonstrated internal trading capabilities.

- Workforce Composition and Consistency Checks: 10%

Staff and RVK, Inc. (RVK), the Plan's general consultant, independently reviewed the remaining ten firms. The independent scores were discussed with the consultant to produce each candidate's final score. Upon completion of the RFP scoring process, the top four firms listed above were advanced to the finalist interview round to present to the Retirement Board.

Staff and RVK recommend further discussion of MFS Investment Management (MFS). MFS currently manages two other mandates for the Plan, U.S. large-cap value equity and international developed value equity. While the LCG mandate submitted by MFS is managed by a completely different team, an element of firm concentration risk exists. If MFS is selected to manage the LCG mandate, total assets under management would be approximately 15% of Plan assets. There are no concerns with the investment management and operational capabilities of MFS, but this issue is brought to the Retirement Board for consideration.

Staff and RVK recommend selecting one manager to fill the LCG equity mandate. The attached memo and report from RVK provides a more in depth summary of the results.

The following documents are attached:

- Resolution No. 18-38
- Correspondence from RVK

Jeremy Wolfson
Chief Investment Officer

LPL/JW/CM/RS:mea

COPY

RESOLUTION NO. 18-38

RESOLUTION TO TERMINATE THE CONTRACT WITH FRED ALGER MANAGEMENT, INC., FOR THE PLAN'S LARGE CAP GROWTH EQUITY MANDATE

WHEREAS, the Board of Administration (Retirement Board) hired Fred Alger Management, Inc. (Fred Alger), to manage a domestic large-cap growth (LCG) equity mandate for the Retirement Fund in February 2004, and for the Retiree Health Benefits Fund in September 2009; and

WHEREAS, the manager has experienced extended periods of underperformance trailing the Russell 1000 Growth benchmark for the three-year, five-year and since inception periods by 3.79%, 1.37%, and 0.08% net of fees, respectively, as of August 31, 2017; and

WHEREAS, Fred Alger ranked in the 86th percentile for the three years and in the 68th percentile for the five years ending June 30, 2017; and

WHEREAS, the performance volatility has been high over the three and five year periods with the manager generating positive returns 44 percent of the time over the three years and 52 percent of the time for the five years, ending August 31, 2017; and

WHEREAS, staff and RVK have concerns over the portfolio manager's non-investment related responsibilities, key man risk, and recent staff turnover, specifically at the senior analyst level of the firm; and

WHEREAS, staff recommends and RVK concurs, that the Retirement Board terminate the contract with Fred Alger and issue an RFP for a domestic LCG equity mandate to seek a replacement for the firm.

NOW, THEREFORE, BE IT RESOLVED, that the Retirement Plan Manager is hereby authorized to

☒ terminate the contract with Fred Alger and issue an RFP for a new domestic large-cap growth equity mandate.

☐ not terminate the contract with Fred Alger.

I HEREBY CERTIFY, the foregoing is a full, true, and correct copy of a Resolution adopted by the Retirement Board of Administration, [created by Section 1102 (b) of the Los Angeles City Charter], at its regular meeting held on November 8, 2017.

L Le

Linda P. Le
Retirement Plan Manager

22.7

Memorandum

To Water & Power Employees' Retirement Plan ("The Plan")
From RVK, Inc. ("RVK")
Subject Large Cap Growth Finalist Recommendation
Date June 13, 2018

Recommendation

After reviewing the RFP responses for the U.S. Large Cap Growth equity search, Plan Staff and RVK recommend that the Board interview the following finalist candidates:

- Jennison Associates
- Los Angeles Capital Management
- MFS Investment Management
- Voya Investment Management

Background

The Plan and RVK launched a Request for Proposal ("RFP") for an U.S. Large Cap Growth equity manager in the first quarter of 2018. Respondents were required to complete the RFP by February 16, 2018. The following minimum qualifications ("MQs") were used to initially reduce the universe to a list of appropriate candidates.

- Firm must have been in existence for at least five (5) full years.
- Firm must be registered with the Securities and Exchange Commission (SEC), a Bank, or a licensed Insurance Company Affiliate.
- Firm must not have been censured by the SEC or subject to regulatory action within the last five (5) years.
- Firm must meet the insurance requirements as outlined in the RFP.
- Firm must comply with City of Los Angeles and the Los Angeles Department of Water and Power requirements outlined in the RFP.
- Firm must agree to obtain a City of Los Angeles Business Tax Registration Certificate.
- Firm must complete the RFP questionnaire in its entirety as well as the City's required attachments pertaining to Worker's Compensation, Child Care and Equal Employment Opportunity, if applicable.
- Firm must be directly responsible for the management of the account, and all personnel responsible for the account must be employees of the firm.
- Firm must agree to accept the Russell 1000 Growth Index as a reasonable benchmark for the mandate over a typical market cycle.

In addition to the minimum qualifications, Plan Staff and RVK established preferred criteria in order to better focus the candidate list on firms that are prepared to offer institutional quality service, and have proven track records of successful investment management in the U.S. Large Cap Growth equity space.

- Total firm assets must be at least $6 billion.
- The firm must manage at least $3 billion dedicated to U.S Large Cap Growth equity.
- The firm must have at least five-years of Global Investment Performance Standards (GIPS) compliant performance history for the period ending 12/31/2017 in the proposed strategy.
- The firm must not have been involved in any material litigation in the past five years.
- The firm must be able to adhere to client-specified portfolio constraints.
- The firm must have (i) at least three existing U.S. based, tax-exempt clients utilizing the large cap growth equity mandate and (ii) one existing portfolio active in this mandate with over $200 million, or two existing portfolios active in this mandate with each over $100 million.
- Results must have closely tracked or exceeded the performance of the Russell 1000 Growth Index, annualized, over the three years ended 12/31/2017.
- The firm must have all firm and product information, including characteristics and performance, uploaded to eVestment.com by the time and date of submission.

Minimum Qualification Review

The U.S. Large Cap Growth equity RFP resulted in 25 responses. After reviewing the responses, nine products failed one or more of the minimum qualifications. Each of these nine managers would have also failed one or more of the preferred criteria. Following this step, there were 16 products subject to further evaluation.

Preferred Criteria Review

The next step in the process was to narrow the list of candidates based on the preferred criteria outlined in the RFP. Candidates that did not fulfill two or more of the criteria were subject to elimination. There were four firms which failed two or more of the preferred criteria resulting in 12 remaining strategies.

Quantitative Screen and Qualitative Discussion

A set of reasonable quantitative screens were then incorporated into the process. This quantitative screening process was augmented with a group discussion of the merits of each firm and strategy. Generally, firms which were deemed to be above median quality were selected for the next stage of the process. Characteristics and statistics analyzed and discussed included, but were not limited to, the criteria listed below.

- Employee Ownership
- Portfolio Manager Industry Experience and Firm Tenure
- Consistency of 3 year Rolling Returns
- Consistency of Calendar Year Returns
- Information Ratio Compared To Peer Group Median
- Sharpe Ratio Compared to Peer Group Median
- Up Capture / Down Capture Ratio

There were five firms which failed one preferred criteria. Of these five firms, two were eliminated as the preferred criteria was performance related and there were no significantly positive attributes which made them as attractive as the rest of the candidates.

However, three of the firms that failed one preferred criteria were included in the next stage. These managers had failed the preferred criteria that candidates should have at least three tax exempt clients invested in the proposed strategy. However, these managers did have clients of significant size invested in the proposed strategy and tax exempt clients invested in other strategies at the firm. These client relationships were viewed as indicative of their ability to service an account of this nature. In addition, other positive attributes, such as a high rate of investment success, firm stability, and team continuity factored into the decision to include these three firms in RFP scoring phase.

Ten firms were identified for further evaluation following this step in the process, which included an in-depth review of the RFP response from each firm.

RFP Scoring and Finalist Recommendation

Plan Staff and RVK independently scored the responses of the ten remaining candidates using a standardized scoring framework. The focus of this analysis included evaluation beyond performance measures. The main objective was to identify firms which had the proper resource stability, experience, and infrastructure to offer a repeatable and proven investment process.

- Firm: 10%
- Team: 15%
- Investment Strategy: 15%
- Risk Control: 15%
- Performance / Quantitative Characteristics: 15%
- Fees: 10%
- Legal, Compliance and Trading: 10%
- Workforce Composition and Consistency Checks: 10%

The independent scores of Plan Staff and RVK were then compared and combined. Plan Staff and RVK held multiple follow-up calls to determine a short-list of candidates to present as finalists for this mandate. A point of discussion was the inclusion of MFS Investment Management as a finalist noting their existing U.S. Large Cap Value Equity and International Developed Equity mandates. The potential addition of the U.S. Growth Equity strategy would result in MFS Investment Management managing approximately 15% of the total Plan assets. A separate management team controls the U.S. Growth Equity strategy. At this point the Board has not contemplated firm concentration risk in the Investment Policy; RVK believes it appropriate to discuss this topic for consideration in the future and to be aware of the potential size of the MFS mandate if they are considered as a finalist for interview. While we have not excluded the manager from this recommendation, we raise the issue for the Board's consideration.

The four firms that were identified as finalists are listed below.

- Jennison Associates
- Los Angeles Capital Management
- MFS Investment Management
- Voya Investment Management

A complete list of the responding firms and the step in which each was eliminated is provided in Appendix A.

Appendix A

The below table includes the 25 RFP responses along with the stage at which each was eliminated.

Firm Name	Stage Eliminated
Allianz Global Investors	Minimum Qualification/Preferred Criteria
BlackRock	Minimum Qualification/Preferred Criteria
BMO Global Asset Management U.S.	Preferred Criteria
ClariVest Asset Management LLC	RFP Scoring
ClearBridge Investments, LLC	RFP Scoring
Columbia Management Investments	Quantitative Screen/Qualitative Discussion
Fred Alger Management, Inc.	RFP Scoring
Goldman Sachs Asset Management	Preferred Criteria
Intech Investment Management LLC	RFP Scoring
J.P. Morgan Investment Management Inc.	Minimum Qualification/Preferred Criteria
Janus Henderson Investors	Minimum Qualification/Preferred Criteria
Jennison Associates LLC	**Finalist**
Loomis, Sayles & Company, L.P.	RFP Scoring
Los Angeles Capital Management	**Finalist**
Mar Vista Investment Partners, LLC	Preferred Criteria
MFS Investment Management	**Finalist**
OakBrook Investments, LLC	Minimum Qualification/Preferred Criteria
TCW	Quantitative Screen/Qualitative Discussion
Vanguard	Minimum Qualification/Preferred Criteria
Voya Investment Management Co. LLC	**Finalist**
Wellington Management Company LLP	Preferred Criteria
Wells Capital (Fundamental)	Minimum Qualification/Preferred Criteria
Wells Capital (Heritage)	Minimum Qualification/Preferred Criteria
Westfield Capital Management Company, L.P.	RFP Scoring
William Blair Investment Management, LLC	Minimum Qualification/Preferred Criteria