MCERA
MERCED COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

INVESTMENT POLICY STATEMENT

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PART I

POLICY PERSPECTIVES

1.0 INTRODUCTION AND POLICY STATEMENT

1.1 Introduction

The Merced County Employees' Retirement Association's ("MCERA" or "Plan") Investment Policy Statement is a document which establishes and outlines the responsibilities of the various parties that are associated with the management of the MCERA. In addition, this document states various control procedures to ensure that the MCERA is appropriately managed. Reports from investment managers, the custodians, consultants and others must verify that they are operating within the framework of the Plan's guidelines.

1.2 Policy Statement

Notwithstanding any other provisions to the contrary, the policy of the Board of Retirement ("Board") of the Merced County Employees' Retirement Association shall be to invest public funds in a manner that is consistent with the County Employees' Retirement Law of 1937, as well as State and Federal laws. The fundamental mission of MCERA is to provide retirement and other benefits to plan participants and to invest Plan assets solely in the interest of Plan participants and beneficiaries.

2.0 POLICY SCOPE

This policy shall set forth guidance and requirements for the investment activities conducted by the Board. The funds eligible for investment are all those under the direct authority of the Board.

3.0 POLICY OBJECTIVES

The basic objectives of the Board's investment program are the following:

3.1 Board Management Objectives

a) Ensure Plan's ability to pay benefits to Plan Participants;
b) Increase funding ratio to ensure long-term sustainability of MCERA;
c) Keep Plan contributions as low as possible once objectives #1 and #2 are met.

3.2 Basic Goals

The goals of the Board are to fund the Plan's benefit payments, while assuming a risk posture that is consistent with the Board's risk tolerance, protect against loss of purchasing power by achieving rates of return above inflation, and seek to obtain a fully funded pension plan status.

3.3 Investment Objectives

The Board's long-term investment objectives are as follows:

a) At a minimum, achieve a nominal return equivalent to the MCERA's actuarial assumed rate of return.
b) Earn a total return that averages in excess of the Actuarial Inflation Rate.
c) Exceed the return of MCERA's passive, market-based, investment benchmark. Allocations to specific asset classes are based on MCERA's target asset mix, which is based on the MCERA's most recent asset allocation study.

4.0 GOVERNANCE

4.1 Board of Retirement's Role and Responsibilities

The MCERA Board of Retirement ("Board") holds the fiduciary responsibility for MCERA. The Board understands it may delegate certain responsibilities under the Investment Program for purposes of administrative efficiency and expertise. The areas the Board may not delegate include:

- The governance model of the Investment Program
- Establishing and maintaining investment policy, including:
  - Investment philosophy
  - This Investment Policy Statement (IPS)
  - Investment objectives
  - Strategic asset allocation
  - Allocation-level performance benchmarks
  - Risk philosophy
- Engaging Board consultants and service providers
- Monitoring the Investment Program

The Board shall act according to the "prudent person rule," which shall be applied in the context of MCERA's investment portfolio. The Board reserves the right to hold all parties doing business with MCERA accountable. The Board reserves the right to delegate an individual to hold an advisory board seat on any Plan investment. The Fund will be invested in a manner consistent with the County Employees' Retirement Law of 1937 and State and Federal laws.

The Investment Policy Statement will be reviewed at least every 3 years.

4.2 Staff Role and Responsibilities

MCERA Staff ("Staff") is broadly responsible for supporting the Board in the effective execution of the Plan. Staff has been delegated authority to execute specific elements of the Investment Program as outlined herein.

- Prepare and Review Recommendations to the Board
- Monitor all transactions and cash flows
- With Board direction, execute cash flows between manager accounts
- Monitor and reconcile custodial bank and managers
- Maintain Investment Manager Watch List
- Notify Manager(s) of their Watch List status
- Monitor for accuracy and validity of invoices and statements
- Provide external managers with IPS
- Ensure compliance with contractual agreements
- Plan Administrator has the authority to manage the investments managers and consultants
- Staff shall act according to the "prudent person rule," which shall be applied in the context of MCERA's investment portfolio.
- Staff shall act reasonably as custodians of the public trust, and shall recognize that the investment portfolio is subject to public review and evaluation. The overall management of the Retirement program shall be designed and managed with a degree of professionalism that is worthy of the public trust.

4.3 General Investment Consultant

The General Investment Consultant ("Consultant") is engaged by the Board to provide independent, objective investment advice, free of conflicts of interest. The Consultant is and shall agree to be a fiduciary to the Plan under California law. The Consultant works with Staff in the development of recommendations while recognizing its fiduciary duty is to provide prudent investment advice to the Board. The Consultant provides advice without discretionary authority to execute on its advice. The specific duties of the Consultant are contained in an Agreement for Investment Consulting Services, and generally include providing advice with respect to:

- Investment strategy development and implementation
- Investment policy development
- Asset allocation among classes and subclasses
- Investment manager selection, evaluation and termination
- Investment performance monitoring
- Investment risk monitoring
- Capital markets projections
- Coordination with the Plan's actuary in conducting periodic asset/liability studies and other required reporting
- Board education
- Collaborate with Staff on Maintaining Watch List

4.4 Specialty Investment Consultants

Specialty Investment Consultants may be hired by the Board to work with Staff, the Board, the General Investment Consultant, other consultants hired by the Board. These will typically be asset class consultants (e.g., real estate, private equity, hedge funds) that may operate on a discretionary or non-discretionary basis, as directed by the Board, to meet the objectives of the Investment Program.

4.5 Investment Managers

Investment Managers are delegated the responsibility of investing and managing Plan assets in accordance with this IPS and all other applicable laws and terms of the applicable investment documents evidencing MCERA's acquisition of an interest in an investment vehicle, and other controlling documents. Each Investment Manager must be 1) an investment advisor registered under the Investment Advisors Act of 1940 and with the Securities and Exchange Commission and/or the applicable regulatory authority in their domiciled country; 2) a bank, as defined by the Act; 3)an insurance company qualified under the laws of more than one state to perform the services of managing, acquiring or disposing of the Plan's assets; 4) a trust operating as an investment company under the Investment Company Act of 1940; or 5) a state chartered trust company authorized to carry on a trust banking business. Each Investment Manager shall agree that it is a fiduciary of the Plan under California law. Subject to this IPS and their specific contractual obligations to the Plan, Investment Managers are responsible for making all investment decisions on a discretionary basis regarding assets placed under their jurisdiction and will be accountable for achieving their investment objectives. Such discretion shall include decisions to buy, hold, and sell investments in amounts and proportions that are reflective of the stated investment mandate. Such investment managers will maintain proper and adequate insurance coverage's including errors & omissions, surety bond, fiduciary liability. In addition, MCERA's investment managers agree to notify the Board Chairman and the Plan Administrator, in writing, if they are unable to continue acting in the capacity of a fiduciary or investment advisor. As stated above, investment managers are expected to act as prudent experts in the management of a fully-discretionary account(s) for MCERA and agree to be fiduciaries to the Plan. In fulfilling their roles, managers will continually educate the Board about capital market developments that pertain to their area of investment expertise.

Investment managers are expected to meet applicable investment objectives over the designated time horizon. If such objectives become unreasonable for any reason, it is the manager's responsibility to communicate his/her reservations about the objectives in writing to the Board Chairman and the Plan Administrator. Otherwise, failure to meet these objectives may result in dismissal.

Satisfying the quarterly portfolio reporting and monitoring requirements of the Plan is also an important part of the manager's responsibilities. These requirements are stated in a subsequent section of this document. Past or any anticipated significant portfolio developments, as well as major changes in the firm's ownership, organizational structure and personnel, should be immediately communicated in writing via e-mail to the Board and its investment consultant. Such communication will in turn be provided to the Board members.

It is the responsibility of each investment manager to provide a current version of its internal code of ethics. Additionally, once a year the manager will provide updated copies of investment and other policies developed by the firm that are relevant to MCERA and its portfolio(s). Policies will be given to the MCERA Staff.

Individual investment managers are hired by the Board to achieve the Plan's goals and investment objectives. In addition, managers are hired to implement Plan's asset allocation decisions, as evidenced by stated fund target asset mix in Appendix A. To the extent possible, investment managers will be hired to fulfill the Plan's diversification policies.

Investment managers are required to inform the Board of any regulatory investigations/ judgments and court cases relating to trading activities. If the investment managers conduct on-going internal reviews of trading activities, results of these reviews will be supplied to the Board.

The Board of Retirement reserves the right to terminate an investment management contract in accordance with the investment agreement for any reason.

4.6 Custodial Bank

The Custodial Bank, selected by the Board to act as the principal custodian of assets of the trust, is delegated the responsibility of holding the assets and evidence of interests owned by the MCERA in investment vehicles and cash (and equivalents). The Board may authorize the Custodial Bank to invest in temporary short-term fixed income investments both for the investment strategies and as a part of the cash portion of Plan assets. Such investments will be managed in general accordance with short-term fixed income investment guidelines as detailed in the custodial agreement. The Custodial Bank, according to the custodial bank agreement/contract, may be authorized to conduct a securities lending program within liquidity and risk constraints as authorized by the custodial agreement.

PART II

MCERA's PORTFOLIO MANAGEMENT

5.0 INVESTMENT POLICIES

5.1 Diversification

As it is prudent to diversify investment risk, the Board has adopted an asset allocation mix to invest in several institutionally acceptable asset classes.

5.2 Managers Diversification and Investment Style

As part of the diversified asset class investment approach of MCERA, the Board will also seek to employ a diverse group of investment portfolio managers within a specific asset class, if the size of the asset class commitment warrants more than one investment manager. Investment style and market capitalization will be used to differentiate among managers in the same domestic and international equity asset classes. The purpose of this diversification is to allow participation in various phases of a market cycle. Investment style diversification will also be applied to MCERA's investments in other asset classes if deemed appropriate.

5.3 Asset Allocation

The Board has adopted a strategic asset allocation based on MCERA's projected actuarial liabilities, liquidity needs, risk tolerance and the risk/return expectations for various asset classes. This asset allocation seeks to optimize long-term returns for the level of risk the Board considers appropriate. The current asset allocation table may be found in Appendix A: Asset Allocation Plan and Target Mix.

Since projected liability and risk/return expectations will change over time, the Board will conduct a periodic review of the strategic asset allocation to maintain an expected optimal allocation. The Board may also revise the asset allocation in response to significantly changing conditions that have affected valuations and/or forward-looking expected returns of asset classes. The Board will review capital market expectations annually.

PART III

INVESTMENT GUIDELINES

6.0 INVESTMENT MANAGERS RESPONSIBILITIES, POLICIES AND GUIDELINES

6.1 Investment Manager Policies

The investment policies governing each investment manager hired by the MCERA are as follows:

a) The investment manager is required to accept the responsibilities in Section 4.5. These responsibilities include acting as a prudent expert and agreeing to be a fiduciary to the MCERA. The investment manager will seek to satisfy the Board's investment objectives. If a problem exists with these objectives, it is the investment manager's responsibility to formally discuss these problems in a written communication to the Board Chairman and the Plan Administrator. Also, the investment manager agrees to satisfy the Board's prescribed quarterly reporting requirements.

b) Under any and all capital market environments, the investment manager agrees to maintain the investment approach that they were hired to implement. Changes to the investment manager's investment decision making process are to be immediately reported in writing to the Board Chairman and Plan Administrator. On-going introspective research of the firm's investment process, analytics, inputs, and decision-making process will be regularly explained in writing to the Board Chairman and Plan Administrator. It is the responsibility of the investment manager to fully educate the Board as to the specifics of its investment process and internal research that may lead to changes in the firm's investment approach.

c) An investment portfolio constructed for the MCERA is expected to generally conform to other portfolios managed by the investment organization, exclusive of specific investment guidelines. When the MCERA's guidelines require the investment manager to manage a portfolio significantly different than its other portfolios, it is the responsibility of the investment manager to communicate in writing the potential impact of the MCERA's guidelines on the portfolio. Notification in writing shall be to the Board Chairman and the Plan Administrator.

d) The investment manager will otherwise treat the MCERA's portfolio in a manner similar to other comparable portfolios in portfolio construction, trading, and all other aspects.

e) The members of the investment management firm's research and portfolio teams are expected to comply with the Chartered Financial Analyst (CFA) Standards of Practice and Code of Ethics. Any industry or regulatory disciplinary action taken against members of the firm's investment staff must be immediately reported in writing to the Board Chairman and Plan Administrator in writing.

f) Portfolios managed for the MCERA are fully discretionary, but must meet the provisions of the MCERA's investment objectives and policies. Investment guidelines also exist for each investment manager within the major asset classes.

g) If the Board delegates proxy voting responsibilities to an investment manager, the manager agrees to vote all proxy ballots according to the best economic interest of the MCERA's members and in a manner consistent with the Board's proxy policies.

h) Investment managers agree to actively support the MCERA's securities lending and commission recapture programs.

6.2 Derivatives Investing Policies

Exposure to risk by use of derivative instruments must be consistent with MCERA's overall investment policy as well as an individual Manager's Specific Investment Guidelines. Any other derivative investment purpose may be allowed by the explicit authorization of the Board. Derivatives may not be introduced into the portfolio to create economic leverage or to create investment exposures that are otherwise excluded by MCERA's Investment Policy unless authorization is given by the Board. Should there be any conflict between an individual Manager's Specific Investment Guidelines and this Policy statement regarding the use of derivative instruments, the MCERA IPS shall control.

6.3 Investment Manager Guidelines

a) Diversification, Liquidity & Restrictions - Portfolio holdings are expected to be well-diversified, so as to avoid excessive volatility and unsystematic risk to the Plan.

b) Cash and Equivalents - Transactional cash, portfolio assets that are temporarily not invested in authorized, longer term securities as stated below, may either be directly invested in allowable high-grade short-term fixed income investments or may be "swept" into the Plan's custodial short-term investment (money market) commingled fund. Allowable high-grade, short-term fixed income investments are as follows: certificates of deposit, commercial paper, U. S. Treasury bills and repurchase agreements. These investments will have short maturities, typically less than 90 days, but none more than 1 year. If an investment is made in the custodian's money market fund, it is the responsibility of the investment manager to make sure that the money market fund has investment guidelines that comply with MCERA's investment objectives and policy statement. At this time, it is not contemplated to allow investment managers to invest in money market funds other than those offered by the custodian. If an investment manager wishes to use non-custodian provided money market funds, this issue must be addressed in writing and directed to the Plan Administrator and the Chair of the Board of Retirement.

c) Domestic Equity Portfolios – Large, Medium and Small Capitalization

The types of assets that may be held in large capitalization, domestic equity accounts are common stock, preferred stock, convertible securities, with the vast majority of holdings in common stock. Large capitalization domestic equity portfolios will primarily invest in stocks with market capitalizations. The vast majority of equity holdings will be in large capitalization issues. Firm's that manage equity portfolios will continually monitor the risk associated with their equity investments. They will be expected to report on the active management decisions they have assumed relative to their respective benchmarks. As a result of this risk/reward analysis, active equity managers will statistically attribute actual performance variance from their benchmarks in each regular quarterly report. Included in this report will be statistics attributing performance to sector weighting decisions versus the benchmark and security selection decisions within each sector relative to the benchmark.

American Depository Receipts (ADR's) of foreign companies and foreign common stocks traded in U. S. dollars and on U. S. exchanges are authorized investments. ADR's and foreign common stocks traded in U. S. dollars and on U. S. exchanges should not exceed 15% of the portfolio.

Derivative securities may not be held in domestic equity portfolios except to mitigate risk, on a temporary basis, of underlying portfolio holdings. Compliance with the previously stated derivatives guidelines must be met.

No single security can represent more than 7% of the market value of a portfolio at the time of purchase, and no single industry (based on Global Industry Classification System - GICS - codes) can represent more than 25% of the market value of the account. If the manager feels another index is more appropriate, this case should be made in writing to the Board Chairman and Plan Administrator.

The above restrictions and guidelines for large capitalization domestic equity portfolios also apply to mid-capitalization domestic equity portfolios, except for the applicable benchmark related requirements. Mid-capitalization, domestic equity portfolios will invest in stocks with market capitalizations consistent with the Plan’s policy benchmarks. If the manager feels another index is more appropriate, this case should be made in writing to the Board Chairman and Plan Administrator.

The above restrictions and guidelines for large capitalization domestic equity portfolios also apply to small capitalization domestic equity portfolios, except for the applicable benchmark related requirements. Small capitalization, domestic equity portfolios will invest in stocks with market capitalizations consistent with the Plan’s policy benchmarks. If the manager feels another index is more appropriate, this case should be made in writing to the Board Chairman and Plan Administrator.

International Equity (Large & Small Cap) Portfolios - Developed & Emerging Markets
Assets in international equity portfolios will be primarily composed of foreign ordinary shares and ADR's (including ADR's that are 144A securities). Short term, high-grade fixed income securities may be purchased as previously stated, similar types of securities denominated in foreign currencies may be purchased, or the Fund's custodial sweep account may be employed. International equity portfolios will invest in stocks with market capitalizations consistent with their underlying benchmarks. Emerging market equity portfolios can invest in stocks with large, mid and small market capitalizations. Firms will continually monitor the country, currency, sector and security selection risks associated with their international and emerging market equity portfolios. All of the risks will be included in the manager's quarterly reports and performance attribution based on these factors will also be included. Currency hedging, consistent with the previously stated derivative policy, is an acceptable investment activity. However, prior to initiating such hedging activities, the firms must adequately demonstrate their capability and expertise in this area to the Board.

Large capitalization international equity portfolios will be measured against the Plan’s policy benchmark. Small capitalization international equity portfolios will be measured against the Plan’s policy benchmark for small cap international equities. Emerging market equity portfolios will be measured against the Plan’s policy benchmark in emerging market equities. If the manager feels another index is more appropriate, this case should be made in writing to the Board Chairman and Plan Administrator.

d) Hedge Funds

The role of hedge funds is to provide a diversified set of risk exposures, little-to-no correlation to the broader equity and credit markets and achieve an attractive risk-adjusted return. The long term investment objective is to exceed LIBOR by 4%.

It is expected that the hedge fund composite (the aggregation of all hedge funds employed by the Plan) should outperform the Policy benchmark for hedge funds, over rolling 3-5 year period.

The hedge fund program will have the flexibility to invest as it sees fit but will typically invest through multi-strategy hedge funds and/or single strategy hedge funds. The Board shall establish investment guidelines for the hedge fund portfolio in aggregate and shall select Investment Managers it believes are positioned to achieve the stated objectives.

The Fund seeks to be diversified across and within strategies, without regard to the specific vehicle (i.e., recognizing that Portfolio Funds may encompass more than one strategy). The following look-through exposure categories may be represented in the Fund:

Market Neutral strategies such as equity market neutral, fixed income arbitrage, and convertible bond arbitrage.

Event Driven strategies such as risk arbitrage, merger arbitrage, activist and other event-driven strategies.

Credit/Distressed strategies such as capital-structure arbitrage, fixed-income arbitrage, and distressed debt/equity.

Equity long/short strategies where there is combination of long and short positions primarily in publicly-traded equities, with a net market exposure less than that of the overall equity market. Strategies may be focused on U.S., non-U.S., and/or specialty mandates.

Global Macro strategies such as all market portfolios, opportunistic long-only, managed futures, currency, dedicated short selling strategies or other specialty strategies.

Multi-strategies where hedge funds invest using a combination of previously described strategies.

The targeted exposure to each strategy is shown in the below table:

Strategy	**Target**	**Min**	**Max**
Market Neutral	18%	10%	30%
Credit/Event	32%	20%	40%
Equity L/S	25%	15%	35%
Global Macro	15%	10%	20%
Multi-Strat	10%	5%	20%
	100%		

Individual hedge fund investments may have specified liquidity parameters defining lock-up periods and withdrawal frequency. Liquidity risk is managed by monitoring and maintaining a schedule of the liquidity of the individual hedge funds and aggregating it at the total Hedge Fund Program level.

e) Private Equity & Private Real Assets

The private markets are inefficient and illiquid due partially to privately negotiated, non-auction pricing mechanisms. High return premiums are expected by investors who are willing to accept the illiquid and inefficient characteristics of the private markets. Therefore, the long-term expected return from private equity markets should exceed the expected return of public equity markets by at least 3%. The long term expected return from the private real assets portfolio should exceed inflation by 5%.

Controlling risk in the private portfolio is equally as important as seeking higher returns. Because private asset classes cannot measure risk in a traditional manner (using quantitative risk measures like standard deviation and benchmark tracking error), risk will be managed through a combination of quantitative and qualitative constraints, such as diversification of investment type and thorough due diligence.

The criteria used to develop partnership allocations will consist of (and not be limited to) geographic location, industry investment orientation, financial funding stage orientation, source of deal flow, and investment size.

Recognizing the importance of vintage year diversification and adequate portfolio diversification by investing in different types of private asset investments, partnerships or other vehicles with managers representing various investment styles, industries and geographic concentrations, an annual plan will be developed and presented to the Board. The annual plan will reflect the pace of commitments and forecasted cash flows which is expected to achieve MCERA's targeted allocation to the private asset class over a reasonable time period. This annual plan will be integrated with the existing portfolio and will be based on the prevailing economic environment and market conditions.

Performance will be reported on a vintage year internal rate of return (IRR) basis. Internal rate of return is a total dollar weighted rate of return where the discount rate equates the net present value (NPV) of an investment's cash inflows with its cash outflows. Vintage year is the year of fund formation and first takedown of capital. The long-term objective is to outperform the benchmark, net of investment management fees, calculated on an IRR basis over rolling ten-year periods. The individual investment vehicle performance, as measured by the internal rate of return, will be evaluated compared to the performance of respective peer universes and vintage years. It is recognized that immature private equity investments will ordinarily have a “J-curve effect” whereby there are low to negative returns in the initial years due to the payment of investment management fees during a period when investments are typically carried at cost and returns have not been realized.

Asset allocation is a critical driver for the long-term success of the private equity program. To control asset allocation risk, investments are diversified through long-term subclass parameters:

- Leveraged Buyouts/Corporate Finance: the acquisition of a product or business that is typically further along the business life cycle, having relatively predictable cash flows and the ability to raise capital utilizing a significant amount of debt and little or no equity.

- Venture Capital: targets companies in the earliest phases of a business cycle. Companies may be classified as seed, early, middle and late stage. These companies have uncertain revenues and a need for cash to build their businesses and are subject to high failure rates

- Special Situations: includes investments in distressed debt, mezzanine, sector, opportunity, and secondary funds.

- Geography/Domestic vs. Global: investments either made in the United States or investments made outside of the U.S. including Europe, Asia, and Canada.

- Infrastructure: investments will be in companies or assets that fall into the infrastructure sector both in domestic and international markets.

- Natural Resources: investments will be in companies or assets that fall into the energy, mining, agriculture and/or timber industries in both domestic and international markets.

Risk will also be controlled by liquidity, vintage year, investment managers, firm, time and geographic and economic region.

- Private investments are illiquid and typically have expected holding periods of 10-12 years. Investments are typically held until maturity and selling prior to maturity may result in realizing a sales price that reflects a discount to fair market value. Liquidity risk is managed by minimizing the possibility of forced sales that may arise from exceeding maximum exposure limits or lowering asset allocation targets to private equity investments.

- Vintage year reflects the year of fund formation and first takedown of capital. Vintage risk refers to the variability of private equity commitments over time. A secondary investment is a vehicle in the special situation subclass that allows the portfolio to gain prior year vintage exposure, further minimizing vintage risk.

- Manager risk consists of the exposure within a partnership and the number of general partners in the private equity portfolio. Most partnerships require minimum commitments, which help control the exposure of partnerships.

- Commitments will be made over the full course of the business cycle and will not be concentrated in any one year.

- Geographic and Economic Region: In the selection of private equity investments, the portfolio will not favor particular economic or geographic regions. Most likely, the focus will be globally oriented.

- MCERA shall ordinarily direct the sale of any securities distributed by its investment vehicles as soon as practically possible and strive to not impair the value of the security.

- Alignment of Interests: General partnership agreements will be actively negotiated. The partnership agreements will ensure that the interests of the general partner are aligned with the limited partners.

For the Private Equity portfolio, the targeted and range of investment exposures, measured at fair value, to the various private equity investment classes are shown in the following table:

	Target	Ranges
Buyout	60%	40-80%
Venture/Growth Eq	20%	10-30%
Opportunistic	20%	10-30%
	100%	

For the Private Real Assets portfolio, the objective is to have the portfolio comprised of half infrastructure investments and half natural resource investments.

If the manager feels another index is more appropriate, this case should be made in writing to the Board Chairman and Plan Administrator.

f) Domestic Fixed Income Portfolios

Acceptable security types for domestic fixed income portfolios are certificates of deposit, commercial paper, other high grade short-term securities, U. S. Government and Agency securities, corporate bonds, mortgage- and asset-backed securities[1] and Yankee bond securities. In addition, taxable municipal bonds, commercial mortgages and trust preferred securities are acceptable security types. Cash and equivalent holdings may be comprised of high grade certificates of deposit, commercial paper, U. S. Treasury bills and repurchase agreements.

Firm's that manage fixed income portfolios will continually monitor the risk associated with their fixed income investments. They will be expected to report on their active investment management decisions they have assumed relative to their respective benchmarks. Statistics which relate performance variance to effective duration decisions, yield curve positioning, sector allocation, security selection and other portfolio management decisions will be included in each quarterly report. Also, to the extent possible, various interest rate scenarios will be depicted in horizon analysis testing, with time horizons spanning the next six months to one year, or longer.

As mentioned above, investments in Yankee bond securities (U.S. dollar denominated international bonds that are registered with the Securities & Exchange Commission) are an acceptable investment.

No single security can represent more than 5% of the market value of a portfolio at the time of purchase, and no single industry (based on Global Industry Classification System - GICS - codes) can represent more than 15% of the market value of the account. These single security and single industry restrictions do not apply to U. S. Government and Agency bond holdings.

g) Opportunistic

Fixed income portfolios that may include credit. Acceptable security types for opportunistic portfolios may include high yield (or below-investment grade) corporate debt and bank loans, sovereign bonds, emerging market debt, investment grade corporate debt, and securitized debt.

The same fundamentally-based research effort required of domestic fixed income managers is also required of opportunistic managers. The goal of the opportunistic credit allocation, either publicly syndicated or privately originated, is to generate high total returns, and/or hedge rising interest rates,

[1]Please note that convertible debt, traditional zero coupon bonds, mortgage-pass through securities and asset-backed securities are technically derivative securities but for the purposes of this Investment Policy Statement these securities are not classified as derivatives. Such investments must be at least BBB rated and meet the risk requirements discussed in the subsequent footnote.

while investing across the full maturity spectrum of corporate securities. Proper diversification is required; such that reasonable risk/reward expectations are maintained. Performance attribution is required, as is the case of domestic fixed income managers. All other requirements of domestic fixed income managers apply to opportunistic fixed income managers.

h) Treasury Inflation Protected Securities (TIPS)

MCERA has also approved the use of TIPS. Either a passive or an active investment approach may be taken toward the management of TIPS portfolios. For active management, the same fundamental and valuation-based research effort required of domestic fixed income managers is also required of TIPS managers. The goal of the TIPS allocation is to protect against inflation and may be implemented through short-term or traditional duration TIPS portfolios. Proper diversification of TIPS portfolios is required; such that reasonable risk/reward expectations are maintained. Performance attribution is required, as is the case of domestic fixed income managers. All other requirements of domestic fixed income managers apply to TIPS portfolios.

i) Real Estate and Private Real Estate

The above restrictions and guidelines for large and small capitalization domestic equity portfolios also apply to Domestic and Global REIT portfolios, except for the following differences. Investments are expected to be primarily in common stocks. A small percentage (less than 10%) may be in preferred stock. No restrictions exist on the market capitalization of Domestic and Global REIT portfolio holdings. In addition, the Domestic and Global REIT benchmarks may have individual security market capitalization weights greater than 5%. As a result, individual security positions in Domestic and Global REIT portfolios may generally reflect the weights in the underlying benchmarks. (It may be that MCERA's Domestic and Global REIT commitment could be in a commingled fund, and that the MCERA would have to accept the investment guidelines of the Domestic and Global REIT fund.)

While global REIT securities are recognized to have real estate and small cap security characteristics, global REIT security portfolios are primarily viewed as an alternative to direct real estate investments or real estate operating companies. These securities also have a higher level of liquidity than direct real estate investments and this is considered a favorable attribute. As such, there is a desire to maintain the favorable liquidity attributes of these securities and not to become over-concentrated in individual portfolio holdings.

In addition to real estate securities, the MCERA will invest in private real estate investment structures that have an ownership interest, directly or indirectly, in real estate properties through either the debt or equity, either income producing or non-income producing. The objective of these funds is to exceed inflation by 5% and to outperform peer universe benchmarks. Real estate funds will be measured against the Plan's policy benchmark in real estate. Diversification will be obtained both through property type and geographical location. It is expected that investments will be primarily in large metropolitan centers. Relatively conservative levels of debt financing will be used in the purchase of income producing real estate properties often called "Core Real Estate". Investments may also be made in investment strategies defined as "Value-Added" or "Opportunistic". "Value-Added" strategies derive their return from both income and appreciation and may include the use of a moderate amount of leverage while "Opportunistic" strategies derive their return primarily through appreciation and they may use a moderate to high degree of leverage. The Core Real Estate Funds are currently the predominant exposure in the Real Estate portfolio and will be used as a placeholder until other private investment opportunities are identified. The criteria used to evaluate such partnerships, the risk parameters that such partnerships will be managed against and the performance benchmarks the individual partnerships will be evaluated by are the same as those outlined in Section 8. Property valuations will be conducted so as to reflect realistic economic value at quarter-end periods.

6.4 Watch List Policy

Purpose of Watch List
In order to more officially monitor and track existing and potential problems at the fund/portfolio management, the Board has adopted the following "watch list" policy. The watch list has been instituted to specifically monitor portfolios and managers on both quantitative and qualitative factors. The purpose of such a list and its procedures is to identify how performance and other issues will be monitored and how they will be responded to in a timely manner. The Board reserves the right to take any action with respect to its investment managers at any time. The watch list policy does not restrict the Board from any action.

Quantitative Screens
The quantitative portion of the watch list will be primarily focused on performance of the fund vs. the appropriate benchmark and peer group.

Qualitative Factors
In addition to the performance screens, several other factors relating to the portfolio/ fund's management and style will be continually monitored. These factors are:

a) The portfolio's fundamental investment characteristics vs. the appropriate market index (benchmark)
b) The portfolio's ability to adhere to its stated investment style
c) Continuity of the portfolio management and analytical research staff members
d) Continuity of firm's senior management and organizational structure
e) Ownership changes of the organization
f) Style drift or changes

Regulatory Developments
The Board reserves the right to take any action with respect to its investment managers at any time.

Watch list status indicates an increased level of concern, but does not indicate major deficiencies. Managers may be placed on MCERA's Watch list for one or more reasons stated below. The Watch list period will be defined by the Board. The Board, with the help of the General Investment Consultant, shall conduct a comprehensive evaluation of the Manager at the end of the one-year Watch list status period to determine whether the Manager may be removed from Watch list status.

A manager may be added to the MCERA Watch List for any of the following criteria:

- Under/Over Performance
- Style Deviation
- Organization Change
- Non-Compliance
- Poor Client Service
- SEC Filings and Investigations
- Fees
- Other criteria as deemed appropriate by the Board of Retirement

Manager may be removed from MCERA's Watch list if the Manager demonstrates adequate improvement in identified areas of concern. The Board reserves the right to remove a manager from the Watch List at any time.

Termination
The Board reserves the right to terminate an investment management contract in accordance with the investment agreement for any reason it deems appropriate.

PART IV

CONTROLS

7.0 PROXY VOTING

Voting Proxy ballots will be for the exclusive benefit of the members and beneficiaries of the Plan. The Board may delegate proxy voting to each respective investment manager.

8.0 TRANSACTIONS, BROKERAGE, AND COMMISSION RECAPTURE PROGRAM

The Board understands their fiduciary responsibility with respect to transactions and hereby instructs their investment managers to seek best execution when conducting all trades. Managers are instructed to seek to minimize commission and market impact costs when trading securities. Also, either internally or through an externally provided transaction cost evaluation service, investment managers are expected to measure the costs associated with their investment trades.

All securities transactions shall be executed through reputable member-firm broker/dealers.

9.0 BOARD REVIEW AND DUE DILIGENCE POLICY

The Board will conduct the monitoring of investment performance and manager structure. On a monthly basis, the Board will review monthly investment reports, investment strategy, market conditions, portfolio manager performance and the status of MCERA's asset allocation plan. The Board, individual trustees or designated Staff and Investment Consultant(s) will meet the Plan’s traditional asset class investment managers once every 18 months.

Providing ongoing oversight of the investment management firms selected to invest MCERA’s assets is an important component of the fiduciary duty of prudent investment. This oversight involves not only monitoring investment performance, but also includes: (1) Understanding the reasons for positive or negative performance; (2) Assuring consistency in the investment process and philosophy utilized in managing the portfolio; (3) Monitoring the organizational structure and financial stability of the firm; (4) Staying abreast of any regulatory actions or litigation involving the firm; (5) Monitoring the firm’s increase or decrease in assets under management; and (6) Obtaining any other information that is relevant and material to understanding the firm’s management of MCERA’s assets. Conducting periodic on-site due diligence meetings and reviews with investment managers is an excellent method for addressing these oversight responsibilities and for assuring that the continued engagement of a particular investment management firm is prudent and in the best interests of MCERA. Accordingly, the Board will endeavor to perform on-site due diligence visits with investment managers, as necessary. Such on-site due diligence meetings will focus on in-depth manager specific issues relevant to the engagement and a report on the meeting will be presented to MCERA’s Board of Retirement. Additional on-site due diligence visits may be undertaken with an investment management firm. The Board may require bi-annual updates on certain investments. Subsequent meetings may be required of the manager with staff and the investment consultant(s).

10.0 POLICY COMPLIANCE REVIEW

This investment policy shall be reviewed every three years at a minimum to ensure MCERA’s compliance with the overall objectives of the Investment Policy Committee.

11.0 PORTFOLIO REBALANCING

a) The investment consultant(s) shall monitor the portfolio regularly and report to the Board not less than quarterly on the advisability of rebalancing the portfolio, unless otherwise specified by the Board.

b) In monitoring the portfolio, the consultant shall be guided by the target asset allocation for each asset class in Appendix A. The Board shall also establish acceptable asset allocation ranges for each of the MCERA's investment classes.

c) The Board has authority to issue instructions to managers to liquidate securities for reallocation to other managers or other asset classes, but shall do so only after considering the recommendation of the Plan Administrator and investment consultant(s).

d) The Plan Administrator, in conjunction with the Investment Consultant(s), may prorate net positive cash flows to asset classes that have fallen beneath their target allocation and are approaching the minimum allocation level. The proration may take into account the asset class' percentage of the total portfolio and the magnitude of the deviation from the target.

    i. When all asset classes are within 2 percent of the target allocation, the Plan Administrator may prorate net positive cash flows to each asset class on a rotating basis in order of the asset class' percentage of the total portfolio.

    ii. The Board may review the allocation of assets to each investment manager as part of the Board's asset allocation review.

Appendix A

ASSET ALLOCATION PLAN AND TARGET ASSET MIX

Based on the MCERA's asset allocation study and acceptance of the proposed target asset mix (as stated in the October 2016 Asset Allocation Study report) the following is the MCERA's target asset mix and allocation ranges. The MCERA will review its asset allocation position as needed or a minimum of once every three to five years.

Allocation Ranges

	Target Mix%	Minimum %	Maximum %
Total Domestic Equity	21.0	15.0	26.0
Developed Market Equity	10.0	5.0	15.0
Emerging Market Equity	8.0	4.0	12.0
Private Equity	15.0	5.0	20.0
Real Estate	8.0	6.0	10.0
Domestic Fixed Income	18.0	13.0	23.0
Opportunistic Fixed Income	5.0	3.0	7.0
Hedge Fund	10.0	5.0	15.0
Real Assets	5.0	3.0	7.0

The market benchmarks for the above asset classes are as follows:

US Equity	Russell 3000
Developed International Equity	80/20 MSCI Europe, Australia & Far East Index (EAFE) Net/MSCI ACWI ex US Small Cap Net
Emerging Markets Equity	MSCI Emerging Markets Index Net
Private Equity*	Primary: Cambridge Global Private Equity & Venture Capital 1 Q Index Lagged' Secondary: Russel 3000 + 3% 1 Q Lagged
Real Estate	Primary: NCREIF ODCE Property Index 1 Q Lagged; Secondary: CPI + 5%
US Fixed Income	Barclays Capital US Aggregate Bond Index
Opportunistic Fixed Income	50/25/25 Barc Agg/Barc HY/CS Lev Loans
Hedge Funds*	HFRI Fund of Funds Composite Index
Real Assets*	Primary: 50/50 Blend of Cambridge Global Infrastructure/ Cambridge Energy Upstream & Royalties and Private Energy Index 1Q Lagged; Secondary: 50/50 Blend S&P Global Infrastructure and S&P Global Natural Resources.
Total Fund Benchmark	Target asset mix percentages are applied to individual asset class benchmarks to arrive at the total fund benchmark. The private equity allocation is scaled in over time.

*Please note that Benchmarks for Private Equity, Real Assets and Hedge Funds presented in MCERA Board of Retirement Meetings by the general investment consultant and the specialized investment consultant may differ.

Appendix B

PLACEMENT AGENT DISCLOSURE POLICY

1. PURPOSE

This Policy sets forth the circumstances under which the Merced County Employees' Retirement MCERA (MCERA) shall require the disclosure of payments to Placement Agents, in connection with MCERA investments in or through External Managers. This Policy is intended to apply broadly to all of the types of investment partners with whom MCERA does business, including the general partners, managers, investment managers and sponsors of hedge funds, private equity funds, real estate funds and infrastructure funds, as well as investment managers retained pursuant to a contract. MCERA adopts this Policy to require broad, timely, and updated disclosure of all Placement Agent relationships, compensation and fees. The goal of this Policy is to help ensure that MCERA investment decisions are made solely on the merits of the investment opportunity by individuals who owe a fiduciary duty to MCERA.

2. APPLICATION

This Policy applies to all agreements with Investment Managers that are entered into on behalf of MCERA. This Policy also applies to existing agreements with Investment Managers. Agreements may be amended in any way to continue, terminate, or extend the term of the agreement or the investment period, increase the commitment of funds by MCERA or increase or accelerate the fees or compensation payable to the Investment Manager (Referred to hereafter as "Amendment".) In the case of an Amendment, the disclosure provisions of this Policy shall apply to the Amendment and original agreement.

3. RESPONSIBILITIES

A. The Board is responsible for:

1. Not entering into any agreement with an External Manager that does not agree in writing to comply with this policy.
2. Not entering into any agreement with an External Manager who has violated this policy within the previous five years. However, this prohibition may be reduced by a majority vote of the Board at a public meeting upon a showing of good cause, as deemed by the Board.

B. Each External Manager is responsible for:

1. Providing a statement in writing that the External Manager will comply with this policy. Notification in writing shall be made to the Chairman of the Board and Plan Administrator.
2. Providing the following information, in writing, to the MCERA Investment Staff within 45 days of the time investment discussions are initiated by the External Manager, but in any event, prior to the completion of due diligence. In the case of Amendments, the Placement Agent Information Disclosure is required prior to execution of the Amendment. All disclosures and notifications shall be made to the Chairman of the Board and the Plan Administrator.
   a. Disclosure of payments or compensation by the External Manager or any of its principals, employees, agents or affiliates, directly or indirectly, to any person or entity to act as a Placement Agent in connection with MCERA investments.

b. A resume for each officer, partner, principal of the Placement Agent detailing the person's education, professional designations, regulatory licenses and investment and work experience. If any such person is a current or former MCERA Board trustee, employee or consultant or a member of the immediate family of any such person, this fact shall be specifically noted.

c. A description of any and all compensation of any kind provided or agreed to be provided to a Placement Agent, including the nature, timing and value thereof. Compensation to Placement Agents shall include, but not be limited to, compensation to third parties as well as employees of the External Manager who solicit or market investments to MCERA or who are paid based upon investment commitments secured by such employees.

d. A description of the services to be performed by the Placement Agent and a statement as to whether the Placement Agent is utilized by the External Manager with all prospective clients or only with a subset of the External Manager's prospective clients.

e. A written copy of any and all agreements between the External Manager and the Placement Agent.

f. A statement whether the placement agent, or any of its affiliates, are registered with the Securities and Exchange Commission or the Financial Industry Regulatory Association, or any similar regulatory agent in a country other than the United States, and the details of that registration or explanation as to why no registration is required.

g. A statement whether the placement agent, or any of its affiliates, is registered as a lobbyist with any state or national government.

h. The names of any current or former MCERA Board Trustee, employees, or consultants who suggested the retention of the Placement Agent.

3. Providing an update of any changes to any of the information provided pursuant to section B.2 above within 14 calendar days of the date that the External Manager knew or should have known of the change in information.

4. Representing and warranting the accuracy of the information described in section B.2 above.

5. Causing its engaged Placement Agent to disclose, prior to acting as a Placement Agent to MCERA;

a. All campaign contributions made by the Placement Agent to any publicly elected MCERA Board Trustee during the prior 24-month period. Additionally, any subsequent campaign contribution made by the Placement Agent to any publicly elected MCERA Board Trustee during the time the Placement Agent is receiving compensation in connection with a MCERA investment shall also be disclosed.

b. All gifts given by the Placement Agent to any MCERA Board Trustee during the prior 24 - month period. Additionally, any subsequent gift made by the Placement Agent to any MCERA Board Trustee during the time the Placement Agent is receiving compensation in connection with a MCERA investment shall also be disclosed.

6. MCERA reserves the right to deem the failure to disclose the information required by 5(a) and 5(b) as a material breach of the agreement with the External Manager.

C. MCERA Staff ("Staff") are responsible for:

1. Providing External Managers with a copy of this Policy at the time that discussions are initiated with respect to a prospective investment or engagement.

2. Confirming that the information in Appendix B Section B above has been received within 45 days of the time investment discussions are initiated, but in any event, prior to the completion of due diligence and any recommendation to proceed with the contract or Amendment.

3. For new contracts and amendments to contracts existing as of the date of the initial

adoption of this Policy, securing the agreement of the External Manager in the final written agreement between MCERA and the External Manager to provide in the event that there was or is an intentional material omission or inaccuracy in the Placement Agent Information Disclosure or any other violation of this Policy, MCERA is entitled to the greater of the reimbursement of any management or advisory fees paid by MCERA for the prior two years or an amount equal to the amounts paid or promised to be paid to the Placement Agent as a result of the MCERA investment; and

4. Prohibiting any External Manager or Placement Agent from soliciting new investments from MCERA for five years after they have committed a material violation of this Policy; provided, however, that MCERA's Board, by majority vote at a noticed, public meeting, may reduce this prohibition upon a showing of good cause.

5. Providing a quarterly report to the Board containing (a) the names and amount of compensation agreed to be provided to each Placement Agent by each External Manager as reported in the Placement Agent Information Disclosures, and (b) any material violations of this Policy; and maintaining the report as a public record.