

**PARS: County of Contra Costa**

**Second Quarter 2016**

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# DISCUSSION HIGHLIGHTS

## U.S. Economic and Market Overview

2016 has delivered heightened levels of volatility, and we have not even made it to the U.S. elections yet. In the first quarter of the year, investors were greeted by the sell-off in equity markets in response to the Federal Reserve's first rate hike in over 7 years. The S&P500 declined roughly -12% from peak to trough, through the first six weeks of the year. Markets rallied in mid-February, upon signals provided by the Federal Reserve Chair Janet Yellen that interest rates are not likely to be increased by more than one or two hikes throughout the calendar year. Domestic equity markets continued their upward trajectory throughout the remainder of the second quarter, until British voters elected to secede from the European Union on June 24<sup>th</sup>. Technically, the vote was non-binding, but the so-called "Brexit" from the EU is widely expected to become a reality. In the immediate aftermath, the swirling uncertainty caused the British Pound to fall to a 30-year low versus the U.S. Dollar, global stock markets to sell off, U.S. Treasury and gold prices to soar as a 'safe haven trade', and Prime Minister David Cameron to announce his resignation. The timetable for Britain's exit could potentially last several years, and it is reasonable to expect the EU to take a punitive stance to discourage similar "exit" movements in other countries. Conversely, the UK will likely aim for minimal economic disruption by seeking to retain as many trade benefits as possible, while shedding the financial and political costs of EU membership. To prevent post-Brexit uncertainty from becoming an overwhelming headwind to financial markets, global central banks will most likely continue accommodative monetary policies. However, after years of pushing policy tools to the max in a protracted effort to avoid deflation, many question whether enough global monetary ammunition remains to counter the new concerns Brexit raises.

In the wake of the first quarter's adjusted annual GDP growth rate of 1.1%, most of the economic data releases in the second quarter were supportive of a reasonable rebound in economic activity. Consumer confidence, as measured by the Conference Board, hit an eight-month high of 98.0 in June. Oil continued its rally off lows set in January as supply side adjustments caused the West Texas Intermediate futures contract to climb to \$48.33 at quarter's end. The U.S. manufacturing sector began to show some signs of improvement as the ISM manufacturing index hit a 16-month high of 53.2 in June. One area of concern was related to employment, where the 11,000 employment gain estimate in May was the lowest reading since the third quarter of 2010. Countering this data point was the initial estimate reading from June where the jobs number posted a gain of 287,000. The three-month average of 147,000 jobs gives light to an economy showing signs of modest growth, as the economy nears full employment.

## Market overview/Performance Discussion

### Total Plan

The County of Contra Costa OPEB Plan returned 1.96% net of investment fees, in the second quarter, which slightly lagged the County's Plan benchmark return target of 2.09%. Returns were supported by modest outperformance in fixed income, as well as our REIT investments. Returns from international investments were also a positive for the Plan from a relative standpoint, supported by performance from emerging market equities. Global equity and mid cap equity matched benchmark returns in the second quarter. Small cap and alternative investments offered performance that was slightly below benchmark targets. The primary drag on performance for the quarter came from investments in large cap equity. Large cap managers continue to struggle in 2016, thru the first six months of the year, 15% of the managers in the Russell 1000 Large Cap Growth universe have outperformed the benchmark. Within the Russell 1000 Value Universe, it is only modestly better at 24%. Our investments in passive ETFs have mitigated some of the deviation to the benchmark in small cap and large cap equity over the past twelve months.

### Domestic Equity

U.S. equity indices posted positive gains across all market capitalization levels with the S&P 500 (+2.5%), Russell Mid Cap (+3.2%), and Russell 2000 (+3.8%) all up in the second quarter. Investors became more convinced that the Federal Reserve would likely be on hold until the fourth quarter, at the earliest in terms of raising the Federal Funds rate. A potential delay for a Fed rate hike was supported by a weak May employment report, a review of the minutes from the two FOMC meetings in the quarter, and a belief that the Fed may be influenced by the potential impact of the Brexit fallout. As bond yields declined in the quarter, investors were drawn to higher yielding stocks, as an alternative income source. Areas such as utilities (+6.8%), consumer staples (+4.7%), and telecommunications (+7.1%) were leading sectors in the quarter. Investment flows have led these sectors to trade at rather full valuations, with the price to earnings ratio of consumer staples (24.0) and utilities (22.7) as notable examples. Energy stocks also outperformed as oil recovered from the lows touched in the first quarter. The Energy sector ended the quarter up +11.6% making it the top performing sector. Conversely, cyclical stocks have been under pressure most of the year. Consumer discretionary (-0.9%), and technology (-2.8%) stocks lagged in the quarter. This divergence is apparent with the performance gap between the Russell 1000 Value Index (+4.6%) and the Russell 1000 Growth Index (+.6%). This outperformance of value vs. growth is somewhat surprising in that the largest sector within large cap value, financials (28% of the large cap value index), has had the largest decline year to date (-1.8%). The Plan has been overweight value over growth since the third quarter of 2015.

- **The Plan's large cap segment returned 1.76% in the quarter, which underperformed the Russell 1000 Index return of 2.54%.**
  - The iShares Russell 1000 ETF returned 2.5% in the second quarter.
  - The Columbia Contrarian Core Fund returned 1.65% in the quarter, which underperformed the benchmark. The Fund ranked in the 60<sup>th</sup> percentile of the Morningstar Large Cap Blend Universe.

- The Harbor Capital Appreciation Fund returned -1.31% in the quarter, which underperformed the Russell 1000 Growth Index's return of 0.61%. The Fund ranked in the 88<sup>th</sup> percentile of the Morningstar Large Cap Growth Universe.
- The T. Rowe Price Growth Stock Fund returned -0.65% in the quarter, which underperformed the Russell 1000 Growth Index. The Fund ranked in the 77<sup>th</sup> percentile of the Morningstar Large Cap Growth Universe.
- The Dodge and Cox Stock Fund returned 1.70% in the quarter, which underperformed the Russell 1000 Value Index's return of 4.60%. The Fund ranked in the 71<sup>st</sup> percentile of the Morningstar Large Cap Value Universe.
- The Loomis Sayles Value Fund posted a 3.17% return in the quarter, which also underperformed the Russell 1000 Value Index. The Fund ranked in the 44<sup>th</sup> percentile of the Morningstar Large Cap Value Universe.
- **The mid cap equity segment returned 3.24% in the quarter, which was in-line with the Russell Mid Cap Equity return of 3.18%.**
  - The iShares Russell Mid Cap ETF returned 3.12% in the second quarter.
- **The small cap equity segment returned 3.45% in the quarter, which trailed the Russell 2000 Index return of 3.79%.**
  - The iShares Russell 2000 ETF returned 3.81% in the second quarter.
  - The T. Rowe Price New Horizons Fund returned 5.18% in the quarter, and outperformed the Russell 2000 Growth Index return of 3.24%. The Fund ranked in the 22<sup>nd</sup> percentile of Morningstar's Small Cap Growth Universe.
  - The Columbia Small Cap Value Fund II returned 2.12% in the quarter, and underperformed the Russell 2000 Value Index's return of 4.31%. The Fund ranked in the 52<sup>nd</sup> percentile of Morningstar's Small Cap Value Universe.

## Real Estate

For the third quarter in a row, REIT equity was the top performing asset class, with the Wilshire REIT Index returning 5.6%. REIT equity returns were aided by the decline in interest rates in the quarter, which prompted investors to seek higher yielding investment options. The 10-year treasury yield has declined by over 80 basis points thru the first six months of this year. Earlier last year, it was announced that REITs were to become the 11<sup>th</sup> GIC sector in the S&P 500. This event will take place in August, and as a result, index related funds will be in a position to add to REIT investments. Analyst estimates put the dollar flow impact of this change anywhere from \$10-\$30 billion of additional investment flows to REITs. Investment dollars have begun to move to the REIT sector in anticipation of this change.

REITs were led in the quarter by Data Centers (+20.6%), Industrial (+15.4%) and Triple Net (+13.3%). Data Centers have been aided by the growth in the migration of “cloud related” service providers. Leasing demand has been strong as corporate data requirements continue to grow and REIT oriented companies that run data centers are benefiting. The Industrial and Triple Net sectors were aided by low interest rates as well as strong fundamentals from the underlying companies that comprise those industries. More cyclically oriented REITs such as lodging (-2.8%) and apartments (-0.9%) struggled in the quarter. Previous reviews have highlighted the struggles within lodging as supply has grown, with Airbnb adding capacity to the sector.

**The Nuveen Real Estate Securities Fund returned 6.49% in the quarter, which underperformed the Wilshire REIT Index return of 5.60%. The Fund placed in the 18<sup>th</sup> percentile of the Morningstar Real Estate Manager’s Universe.**

## Global/International Equity

International equity market performance thru the first five months of 2016 was impacted by the Chinese economy, the recovery in Europe, the pace of interest rate normalization in the U.S, and the ensuing impact on the U.S dollar. An addition to this list came in June when the British citizens voted to secede from the European Union (Brexit). Britain is the 5<sup>th</sup> largest economy in the world, and the second largest economy in the EU. The anticipated exit from the EU accentuates uncertainties with respect to global trade, geopolitical tension, the future of the UK, and the future of the EU itself. The EU is struggling to recover from a multi-year economic malaise, and this event will challenge a current environment that is marked by high unemployment, slow growth, and low levels of consumer and business confidence.

In the quarter across Europe, equity markets performed poorly, led by Italy which returned -10.4%. Italy's Banks have come under pressure as nonperforming loans are rising to dangerous levels, currently around 8% of total loans. Across other regions, Japan attempted to calm investors by delaying their planned consumption tax rise till 2019. It may take more than delaying a tax increase to ignite the troubled economy. Speculation continues to grow about the potential for more unconventional monetary policy measures out of the Japanese Central Bank.

Emerging Markets have finally started to contribute to global equity returns in 2016. While underperforming U.S. markets for the quarter, the MSCI Emerging Market Index is outperforming for 2016 with a 6.5% return, in USD terms. Brazil and Russia were top performers returning 46.3% and 20.4%, respectively. Both countries have been beneficiaries of higher oil prices that climbed by over 50% off the lows hit in the first quarter. The price of oil will be a likely driver of these countries performance going forward. China was less of a concern to markets in the second quarter, displayed by its 0.1% return. While that is not encouraging, the Chinese equity markets may have stabilized after a disappointing previous 12 months. Broadly speaking, emerging market nations have been showing tentative signs of improvements.

Global currencies displayed a wide range of outcomes in the quarter, and had corresponding impacts to dollar based investors. When measured against the USD, the British Pound fell by more than -10% upon the first week of the Brexit vote, and ended down over -8% for the quarter. The Euro fell by -2.5%, and the Yen appreciated by close to 10%. Emerging market currencies were more resilient, especially for those countries linked to basic materials. The Brazilian Real was up 10.6% and the Russian Ruble appreciated 4.7%.

- **The Plan's international/global equity segment returned 0.32% in the quarter. This return outperformed the MSCI EAFE Index -1.46%, and underperformed the MSCI ACWI Index return of 0.99%.**
  - The iShares MSCI EAFE Index ETF returned -1.4% in the quarter.
  - The Nationwide Baird International Equity Fund returned -2.0% in the quarter, which underperformed the MSCI EAFE Index. The Fund ranked in the 75<sup>th</sup> percentile of the Morningstar Foreign Large Blend Universe.
  - The Dodge & Cox International Stock Fund returned -1.2% in the quarter and outperformed the MSCI EAFE Index. The Fund ranked in the 55<sup>th</sup> percentile of the Foreign Large Blend Universe as measured by Morningstar.
  - The MFS International Fund returned 0.55% in the quarter and outperformed the MSCI EAFE Index. The Fund ranked in the 30<sup>th</sup> percentile for foreign large cap growth managers as measured by Morningstar.
  - The iShares MSCI ACWI Index ETF returned 1.08% in the quarter
  - The American Funds New Perspective Fund recorded a 0.83% return in the second quarter, which underperformed the MSCI ACWI Index and ranked in the 49<sup>th</sup> percentile within the Morningstar World Stock Universe
  - The MFS Global Equity R5 Fund returned 0.67%, which underperformed the benchmark and ranked in the 54<sup>th</sup> percentile of the Morningstar World Stock
  - The Schroder Emerging Market Equity Fund returned 2.32% during the quarter and outperformed the MSCI Emerging Market benchmark return of 0.66%. The Fund ranked in the 46<sup>th</sup> percentile of the Morningstar Emerging Market Universe.

## Fixed Income

The Barclays Capital U.S. Aggregate Bond Index returned 2.2% in the second quarter as investment-grade corporate bonds generated a 3.6% gain, agency mortgage-backed securities advanced 1.1%, and U.S. Treasuries increased 1.6%. For the quarter, ten-year bond yields declined 30 basis points, while the 30-year yield fell 32 basis points, resulting in returns for these securities of 3.0% and 7.2% respectively. Investment grade corporate bonds outperformed U.S. Treasury securities by 99 basis points, while high yield corporate securities gained 5.5% for the quarter, outperforming equivalent duration Treasuries by 411 basis points. Among corporate bonds, the best performing industries this quarter were Metals, Energy, Basic Industry and Media Entertainment. Index laggards included Diversified Manufacturing, Telecom, Retailers, Consumer Non-cyclical, and Technology.

The recovery from the dramatic decline in risk assets that began in the first quarter continued during the second as commodity prices rallied another 13%, while crude oil alone gained 26%. Treasury rates declined despite the recovery in commodity prices and risk assets as global growth continued to disappoint. The combination of slow growth, low inflation, and the ever increasing levels of debt necessary to sustain even this lower level of activity has led to more volatility as markets oscillate between the fear of recession, and the expectation of a return to faster growth. The surprise decision by voters in the UK to leave the European Union caused another period of volatility as investors anticipated that the resulting uncertainty would lead to slower growth, and perhaps even a recession, as individuals and businesses postpone a variety of activities until the future becomes clearer. Although the decision could be interpreted as a retreat from further integration of global markets, and therefore slower growth in the long term, markets have mostly recovered near term as it will take some time for the UK to extricate itself from the EU after being a member for over forty years. And, of course, in the event of a further slowdown, additional central bank stimulus might be forthcoming.

As the amount of global sovereign debt trading at negative yields continues to grow, so too does the demand for any asset with a positive yield. Since yields in the U.S. are still positive across the curve foreign buyers have increased their purchases of U.S. securities, contributing to the downward pressure on U.S. interest rates. Despite predictions at the beginning of the year that rates would trend higher, ten-year Treasury yields declined 80 basis points in the six months ending June, and there doesn't appear to be much upward pressure from here. After extreme volatility during the first quarter, Investment-grade corporate bond spreads narrowed from +170 bp in March to +162 bp at the end of June, remaining very close to the long term average. Although we reduced our corporate exposure by another 5% during the quarter, we remain overweight high quality investment-grade bonds as they continue to offer a significant yield advantage over Treasuries. High yield corporate bond spreads are slightly below their long term average, especially after adjusting for the energy sector. However, given the uncertain economic outlook, particularly for the commodity sector, we don't believe below average spreads are sufficient compensation for above average risk.



- **The Plan's fixed income segment returned 2.53% in the quarter, which outperformed the Barclays Aggregate return of 2.21%.**
  - The separately managed fixed income portfolio returned 2.51% which exceeded the benchmark. The portfolio would have ranked approximately in the 38th percentile of the Morningstar Intermediate Term Bond Universe.
  - The PIMCO Total Return Bond Fund posted a 2.07% in the quarter, which placed it in the 72<sup>nd</sup> percentile of Morningstar's Intermediate-Term Bond Universe. The Fund underperformed the Index.
  - The PIMCO High Yield Bond Fund returned 3.32% in the quarter, and underperformed the Merrill Lynch US High Yield BB-B Constrained Index return of 4.61%. The Fund ranked in the 76<sup>th</sup> percentile of Morningstar's High Yield Universe. We sold out of the Fund on June 13, 2016.
  - The Prudential Total Return Bond Fund was purchased on May 25, 2016. For the quarter, the managers returned 3.25%, which ranked in the 4<sup>th</sup> percentile of the Morningstar Intermediate-Term Bond Universe

### Alternative Investments

The Alternatives portion of the portfolio returned 0.83% in the second quarter, driven by positive performance from the AQR Managed Futures Fund (+1.76%), and the Eaton Vance Global Macro Fund (+1.31%). The only Fund to generate a negative return in the quarter was the AQR Market Neutral Fund (-1.7%). The argument for the inclusion of alternatives in the Plan is that these investments maintain a low correlation with the core elements of traditional equity and fixed income investments that comprise the bulk of the Plan investments. The Eaton Vance Global Macro Fund displayed these characteristics throughout the quarter with positive contributions coming from long credit exposure to Zambia and Angola. As well, a short position in Saudi Arabia rate investments benefited from the country's budget issues, caused by lower oil prices and rising governmental borrowing. Other investments that aided returns included a long position in Russian bonds. The AQR Managed Futures fund was the best performer of the alternatives allocation returning 1.76%. The fund performed favorably in the wake of the surprise decision to leave the EU from the U.K. The fund gained over 5% in the last few days of the quarter, as it tends to perform well when market volatility increases. Fixed income, currencies, and commodities were the leading sectors, while equity investments detracted in the quarter. Long investments in U.S. 20-year and 30-year treasuries aided fund returns. The only detractor in the quarter was the AQR Market Neutral Fund which was negatively impacted by positions in French equities, and a net short position in the energy sector.

- **The alternative investment segment returned 0.83% in the second quarter, which slightly underperformed the Wilshire Liquid Alternatives Index return of 1.03%.**
  - The Eaton Vance Global Macro Absolute Return Fund posted a 1.31% return, which placed in the 60<sup>th</sup> percentile of the Morningstar Non-Traditional Bond Universe.
  - The AQR Managed Futures Fund's return of 1.76% ranked in the 31<sup>st</sup> percentile of Morningstar's Managed Futures Fund Universe.
  - The AQR Market Neutral Fund returned -1.71%, and ranked in the 69<sup>th</sup> percentile of the Morningstar Market Neutral Universe.

## **Asset Allocation/Portfolio Transitions**

We sold out of our high yield allocation in the quarter. This was motivated by profit taking in that the high yield sector has rapidly appreciated in price as the price of oil has offered support to many energy sector related high yield issues.

We initiated an investment in a new fixed income manager, the Prudential Total Return Bond Fund. We sourced this investment with funds from our internally managed core fixed income investment and the Pimco Total Return Bond Fund.

We sold out of our investment in the Dow Jones Euro Stoxx 50 ETF in May. We had concerns regarding the outcome of the British referendum vote. The proceeds of this liquidation were reinvested into both emerging and developed international equity investments.

We moved to an overweight to REIT investments, increasing our allocation by +0.5%.

# Manager Watch List

<i>Name of Fund</i>	<i>Date on watch list</i>	<i>Date exiting watch list</i>	<i>Recommendation</i>	<i>Rationale</i>
<i>MFS International Growth</i>	4Q 2014	2Q 2016	Remove from list, retain investment in the Plan	Performance has improved over the last 3 quarters.
<i>Pimco Total Return Bond Fund</i>	4Q 2014		Review	We are monitoring both personnel turnover and asset flows. Peer ranking for 3-year period is moving towards sub-median. In the quarter, we re-allocated some of the Pimco investment dollars into the Prudential Total Return Bond Fund
<i>Pimco High Yield Bond Fund</i>	4Q 2015	2Q 2016	Sold	We decided to exit our high yield allocation. This decision was based on the asset class, rather than the underlying manager.
<i>Eaton Vance Global Macro Absolute Return Fund</i>	3Q 2015		Review	Investment returns are not exceeding expectations of alternative category: Cash + 3 to 4% return
<i>Dodge and Cox International Stock Fund</i>	2Q 2016		Review	Significant underperformance over the last 6 quarters has led to performance that has lagged both the benchmark (97 <sup>th</sup> percentile over previous 12 months), and peer ranking for 3-year period is below the median.

## Asset Allocation Period Ending June 30, 2016

Asset Allocation	3/31/2016 Market Value	3/31/2016 % of Total	6/30/2016 Market Value	6/30/2016 % of Total	Target Allocation
<b>Large Cap Equities</b>					
Columbia Contrarian Core Z	5,928,854	3.3%	6,200,751	3.2%	--
iShares Russell 1000 ETF	10,417,443	5.7%	10,897,070	5.6%	--
Dodge & Cox Stock Fund	4,106,816	2.3%	4,240,056	2.2%	--
Loomis Sayles Value Fund	4,105,608	2.3%	4,281,600	2.2%	--
Harbor Capital Appreciation Instl	2,279,933	1.3%	2,365,457	1.2%	--
T. Rowe Price Growth Stock Fund	2,275,918	1.3%	2,361,967	1.2%	--
<b>Total Large Cap Equities</b>	<b>\$ 29,114,573</b>	<b>16.0%</b>	<b>\$ 30,346,900</b>	<b>15.5%</b>	<b>17.0%</b>
		<i>Range</i>		<i>Range</i>	<i>13-32%</i>
<b>Mid Cap Equities</b>					
iShares Russell Mid-Cap ETF	6,363,818	3.5%	6,612,783	3.4%	--
<b>Total Mid Cap Equities</b>	<b>\$ 6,363,818</b>	<b>3.5%</b>	<b>\$ 6,612,783</b>	<b>3.4%</b>	<b>6.0%</b>
		<i>Range</i>		<i>Range</i>	<i>2-10%</i>
<b>Small Cap Equities</b>					
iShares Russell 2000 ETF	6,820,893	3.8%	7,054,598	3.6%	-
Columbia Small Cap Value Fund II	5,924,719	3.3%	6,198,509	3.2%	-
T. Rowe Price New Horizons Fund	2,753,725	1.5%	2,895,666	1.5%	--
<b>Total Small Cap Equities</b>	<b>\$ 15,499,336</b>	<b>8.5%</b>	<b>\$ 16,148,773</b>	<b>8.3%</b>	<b>8.0%</b>
		<i>Range</i>		<i>Range</i>	<i>4-12%</i>
<b>International Equities</b>					
Nationwide Bailard Intl Equities I	4,986,827	2.7%	5,060,956	2.6%	--
iShares MSCI EAFE Index Fund	5,827,291	3.2%	6,820,646	3.5%	--
Dodge & Cox International Stock Fund	2,742,601	1.5%	2,709,793	1.4%	--
MFS International Growth Fund	2,740,572	1.5%	2,755,682	1.4%	--
Schroder Emerging Market Equity	1,849,554	1.0%	2,999,151	1.5%	--
SPDR EURO STOXX 50 ETF	1,790,200	1.0%	--	--	--
<b>Total International Equities</b>	<b>\$ 19,937,044</b>	<b>11.0%</b>	<b>\$ 20,346,227</b>	<b>10.4%</b>	<b>9.0%</b>
		<i>Range</i>		<i>Range</i>	<i>4-16%</i>
<b>Global Equities</b>					
MSCI iShares ACWI Index ETF	6,316,504	3.5%	6,552,201	3.4%	
American Funds New Perspective F2	2,735,898	1.5%	2,831,922	1.4%	
MFS Global Equity FD CL R5 #4818	2,738,816	1.5%	2,818,603	1.4%	
<b>Total Global Equities</b>	<b>\$ 11,791,219</b>	<b>6.5%</b>	<b>\$ 12,202,727</b>	<b>6.2%</b>	<b>7.0%</b>
		<i>Range</i>		<i>Range</i>	<i>4-12%</i>

## Asset Allocation Period Ending June 30, 2016

Asset Allocation	3/31/2016 Market Value	3/31/2016 % of Total	6/30/2016 Market Value	6/30/2016 % of Total	Target Allocation
<b>Real Estate</b>					
Nuveen Real Estate Secs I Fund	7,245,638	4.0%	8,852,548	4.5%	--
<b>Total Real Estate</b>	<b>\$ 7,245,638</b>	<b>4.0%</b>	<b>\$ 8,852,548</b>	<b>4.5%</b>	<b>4.0%</b>
		<i>Range</i>		<i>Range</i>	<i>0-8%</i>
<b>Fixed Income</b>					
Core Fixed Income Holdings	56,223,111	30.9%	53,865,308	27.6%	--
PIMCO Total Return Instl Fund	10,002,063	5.5%	8,582,406	4.4%	--
Prudential Total Return Bond Q	-- --	--	8,459,784	4.3%	--
PIMCO High Yield Instl	1,793,679	1.0%	3,578	0.0%	--
<b>Total Fixed Income</b>	<b>\$ 68,018,852</b>	<b>37.4%</b>	<b>\$ 70,911,076</b>	<b>36.3%</b>	<b>38.0%</b>
		<i>Range</i>		<i>Range</i>	<i>30-50%</i>
<b>Alternatives</b>					
AQR Managed Futures I	7,735,255	4.3%	8,400,224	4.3%	--
Eaton Vance Gbl Macro Abs Ret I	7,747,317	4.3%	8,112,085	4.2%	--
AQR Equity Market Neutral I	4,537,821	2.5%	4,776,932	2.4%	--
<b>Total Alternatives</b>	<b>\$ 20,020,393</b>	<b>11.0%</b>	<b>\$ 21,289,241</b>	<b>10.9%</b>	<b>10.0%</b>
		<i>Range</i>		<i>Range</i>	<i>5-20%</i>
<b>Cash</b>					
Money Market	3,735,303	2.1%	8,759,419	4.5%	--
<b>Total Cash</b>	<b>\$ 3,735,303</b>	<b>2.1%</b>	<b>\$ 8,759,419</b>	<b>4.5%</b>	<b>1.0%</b>
		<i>Range</i>		<i>Range</i>	<i>0-5%</i>
<b>TOTAL</b>	<b>\$ 181,726,175</b>	<b>100.0%</b>	<b>\$ 195,469,693</b>	<b>100.0%</b>	<b>100.0%</b>

## Investment Summary

### Period Ending June 30, 2016

Investment Summary	Second Quarter 2016	Year to Date 2016
<b>Beginning Value</b>	<b>\$ 182,068,089.10</b>	<b>\$ 175,078,576.28</b>
Net Contributions/Withdrawals	10,056,628.58	14,999,943.38
Fees Deducted	-44,172.19	-87,554.20
Income Received	905,355.26	1,866,447.04
Market Appreciation	2,829,136.71	4,044,482.54
Net Change in Accrued Income	69,996.84	-16,860.74
<b>Ending Market Value*</b>	<b>\$ 195,885,034.30</b>	<b>\$ 195,885,034.30</b>

Investment Summary	Second Quarter 2015	Year to Date 2015
<b>Beginning Value</b>	<b>\$ 164,399,416.94</b>	<b>\$ 155,218,379.57</b>
Net Contributions/Withdrawals	10,237,432.37	15,083,965.69
Fees Deducted	-43,812.57	-86,547.64
Income Received	543,074.66	1,161,650.83
Market Appreciation	-2,146,385.17	1,674,156.75
Net Change in Accrued Income	262,116.07	200,237.10
<b>Ending Market Value</b>	<b>\$ 173,251,842.30</b>	<b>\$ 173,251,842.30</b>

\*Ending Market Value differs from total market value on the previous page due to differences in reporting methodology. The above ending market value is reported as of trade date and includes accruals. The Asset Allocation total market value is reported as of settlement date.

# INVESTMENT STRATEGY

As of June 30, 2016

## Tactical Asset Allocation

Asset Class	% Portfolio Weighting			Rationale
	Target	Current Portfolio	Over/Under Weighting	
Cash	1.0%	4.5%	3.5%	<ul style="list-style-type: none"> <li>The cash allocation is higher than the target allocation of 2%, due to a contribution that came into the Plan at the end of the quarter.</li> </ul>
Fixed Income	38.0%	36.25%	-1.75%	<ul style="list-style-type: none"> <li>When the quarter-end contribution is invested, we will seek to target a fixed income allocation of 37.5%. We see the low yields offered by fixed income investments as not compelling. We believe the Fed will likely raise rates 1 – 2 times in calendar year 2016. Our year-end target for the 10-year treasury is 1.75%- 2.0%, which implies a decline in price from current levels.</li> </ul>
High Yield	0.0%	0.0%	-	<ul style="list-style-type: none"> <li>We eliminated our high yield position in the quarter. High-yield has rallied in tandem with a recovery in the price of oil. The energy sector, within high yield has seen spreads narrow year to date. We have decided to take profits in this sector due to the sharp recovery in high yield bond prices.</li> </ul>
Alternatives	10.0%	11.0%	+1.0%	<ul style="list-style-type: none"> <li>Alternatives serve to mitigate the impact of a decline in the bond market, due to a potential rise in interest rates. Additionally near-term expectations for cash and equities remain depressed due to the low interest rate environment, equity market valuations, and earnings growth expectations.</li> </ul>
Real Estate (REITS)	4.0%	4.5%	+0.5	<ul style="list-style-type: none"> <li>We increased our allocation to a slight overweight position relative to the Plan benchmark. Earnings and cash flow fundamentals are improving for REITs. Employment trends are providing additional support for REITs. The move by S&amp;P to make REITs the 11<sup>th</sup> GIC sector should offer a modest catalyst regarding money flows into the sector.</li> </ul>
Global Equity	7.0%	6.25%	-0.75%	<ul style="list-style-type: none"> <li>Global equities remain at reasonable valuations due to the international equity component of the MSCI ACWI benchmark.</li> </ul>
International (Developed)	9.0%	9.0%	-	<ul style="list-style-type: none"> <li>Developed international equity markets are viewed as attractive on a relative valuation basis, with superior earnings growth potential supported by earlier stages of the economic recovery cycle. Ongoing ECB and BOJ QE programs are expected to support asset prices. Brexit ramifications may pose a headwind over the near term.</li> </ul>
International (Emerging)	0.0%	1.5%	+1.5%	<ul style="list-style-type: none"> <li>A seemingly successful round of Chinese fiscal and monetary stimulus combined with a pause in US monetary policy normalization have reduced some risks to emerging markets in the near term. Global economic activity is marginally improving as seen in PMI improvements and the Chinese reserve balance has flattened indicating stability in the currency.</li> </ul>
Total Domestic Equity	31.0%	27.0%	-4.0%	
Large Cap	17.0%	15.5%	-1.5%	<ul style="list-style-type: none"> <li>The multi-year outperformance of domestic equities has generated stretched valuations, thereby reducing risk premiums and degrading the near-term risk/reward outlook.</li> </ul>
Mid Cap	6.0%	3.25%	-2.75%	<ul style="list-style-type: none"> <li>We continue to remain underweight based on valuation concerns, with the Russell Mid-Cap Index trading at a 18X forward PE ratio.</li> </ul>
Small Cap	8.0%	8.25%	+0.25%	<ul style="list-style-type: none"> <li>We maintain a slight overweight to small cap stocks. Earnings estimates have come down considerably for small cap equities. Additionally, there is low analyst dispersion related to earnings, which tends to imply less uncertainty.</li> </ul>

**Selected Period Performance**  
**PARS/COUNTY OF CONTRA COSTA PRHCP**  
**Account 6746038001**  
**Period Ending: 06/30/2016**

Sector	3 Months	Year to Date (6 Months)	1 Year	3 Years	5 Years	Inception to Date (65 Months)
Cash Equivalents	.08	.14	.18	.07	.05	.05
<i>iMoneyNet, Inc. Taxable</i>	.03	.05	.06	.03	.03	.03
Fixed Income ex Funds	2.51	5.81	6.02	4.06	4.05	4.34
Total Fixed Income	2.53	5.62	5.71	4.01	4.09	4.36
<i>BC US Aggregate Bd Index</i>	2.21	5.31	6.00	4.06	3.76	3.96
Total Equities	2.08	1.85	-2.12	7.41	7.84	7.55
Large Cap Funds	1.76	1.07	-.06	10.50	11.13	10.14
<i>Russell 1000 Index</i>	2.54	3.74	2.93	11.48	11.88	11.70
Mid Cap Funds	3.24	5.48	-1.44	8.82	8.98	8.92
<i>Russell Midcap Index</i>	3.18	5.50	.56	10.80	10.90	11.18
Small Cap Funds	3.45	2.49	-4.35	9.16	10.47	10.38
<i>Russell 2000 Index</i>	3.79	2.22	-6.73	7.09	8.35	8.94
REIT Funds	6.54	10.98	23.67	13.35	12.06	12.04
<i>Wilshire REIT Index</i>	5.60	11.09	22.82	13.63	12.48	12.89
International Equities	.32	-.61	-7.14	2.93	2.25	2.57
<i>MSCI AC World Index</i>	.99	1.23	-3.73	6.03	5.38	5.54
<i>MSCI EAFE Index</i>	-1.46	-4.42	-10.16	2.06	1.68	2.02
<i>MSCI EM Free Index</i>	.66	6.41	-12.06	-1.56	-3.78	-2.85
Alternatives	.83	1.22	1.18	2.68		
<i>Dynamic Alternatives Index</i>	1.03	.95	-2.53	.86	-.36	-1.05
Total Managed Portfolio	1.98	3.09	1.29	5.49	5.86	5.62
Total Account Net of Fees	1.96	3.04	1.19	5.38	5.73	5.50
<i>County of Contra Costa</i>	2.09	3.56	1.94	6.05	6.07	6.28

Inception Date: 02/01/2011

\* Benchmark from February 1, 2011 to June 30, 2013: 18% Russell 1000 Index, 6% Russell Midcap Index, 8% Russell 2000 Index, 8% MSCI ACWI Index, 10% MSCI EAFE Index, 45% Barclays Aggregate Index, 4% DJ Wilshire REIT Index, 1% Citigroup 3 Month T-Bill Index. From July 1, 2013 to June 30, 2015: 17% Russell 1000 Index, 6% Russell Midcap Index, 8% Russell 2000 Index, 7% MSCI AC World US Index, 9% MSCI EAFE Index, 38% Barclays Aggregate Index, 4% DJ Wilshire REIT Index, 10% HFRI FOF Market Defensive Index, 1% Citigroup 3 Month T-Bill Index. From July 1, 2015: 17% Russell 1000 Index, 6% Russell Midcap Index, 8% Russell 2000 Index, 7% MSCI AC World Index, 9% MSCI EAFE Index, 38% Barclays Aggregate Index, 4% DJ Wilshire REIT Index, 10% Wilshire Liquid Alternative Index, 1% Citigroup 3 Month T-Bill Index

\*\* Dynamic Alternatives Index represents the HFRI FOF Market Defensive Index from 07/01/2013 until 06/30/2015, and then the Wilshire Liquid Alternatives Index from 07/01/2015 forwards.

Returns are gross-of-fees unless otherwise noted. Returns for periods over one year are annualized. The information presented has been obtained from sources believed to be accurate and reliable. Past performance is not indicative of future returns. Securities are not FDIC insured, have no bank guarantee, and may lose value.



# COUNTY OF CONTRA COSTA

For Period Ending June 30, 2016

LARGE CAP EQUITY FUNDS											
Fund Name	Inception	3-Month Return	Rank	YTD Return	Rank	1-Year Return	Rank	3-Year Return	Rank	5-Year Return	Rank
Columbia Contrarian Core Z	(7/13)	1.65	60	2.28	51	2.29	33	11.95	6	12.45	5
T. Rowe Price Growth Stock I		-0.65	77	-5.94	90	-2.59	55	12.46	19	12.08	11
Harbor Capital Appreciation Instl		-1.31	88	-6.73	93	-4.67	76	12.71	16	10.95	30
Loomis Sayles Value Fund	(7/11)	3.17	44	1.46	75	-3.45	74	7.95	54	9.92	41
Dodge & Cox Stock	(10/14)	1.70	71	0.70	83	-5.09	83	8.28	48	10.44	29
iShares Russell 1000	(3/15)	2.50	--	3.68	--	2.83	--	11.34	--	11.74	--
<b>Idx: Russell 1000</b>		<b>2.54</b>	<b>--</b>	<b>3.74</b>	<b>--</b>	<b>2.93</b>	<b>--</b>	<b>11.48</b>	<b>--</b>	<b>11.88</b>	<b>--</b>
MID CAP EQUITY FUNDS											
iShares Russell Mid-Cap	(3/15)	3.12	--	5.40	--	0.39	--	10.61	--	10.73	--
<b>Russell Mid Cap TR USD</b>		<b>3.18</b>	<b>--</b>	<b>5.50</b>	<b>--</b>	<b>0.56</b>	<b>--</b>	<b>10.80</b>	<b>--</b>	<b>10.90</b>	<b>--</b>
SMALL CAP EQUITY FUNDS											
Columbia Small Cap Value II Z		2.12	52	2.79	70	-4.27	48	7.72	28	8.75	28
<b>Idx: Russell 2000 Value</b>		<b>4.31</b>	<b>--</b>	<b>6.08</b>	<b>--</b>	<b>-2.58</b>	<b>--</b>	<b>6.36</b>	<b>--</b>	<b>8.15</b>	<b>--</b>
iShares Russell 2000	(3/15)	3.81	--	2.26	--	-6.63	--	7.15	--	8.41	--
T. Rowe Price New Horizons I		5.18	22	0.92	34	-2.10	12	11.63	2	13.05	1
<b>Idx: Russell 2000 Growth</b>		<b>3.24</b>	<b>--</b>	<b>-1.59</b>	<b>--</b>	<b>-10.75</b>	<b>--</b>	<b>7.74</b>	<b>--</b>	<b>8.51</b>	<b>--</b>
INTERNATIONAL EQUITY FUNDS											
Dodge & Cox International Stock		-1.20	55	-4.91	75	-18.86	97	0.37	79	1.02	52
Nationwide Bailard Intl Eqs Instl		-2.00	75	-3.92	62	-8.75	31	4.40	7	2.49	16
MFS International Growth I		0.55	30	2.10	6	-3.01	16	3.21	47	2.47	46
MFS Global Equity R5	(3/15)	0.67	54	2.79	26	-1.41	25	7.29	22	8.01	9
iShares MSCI EAFE	(3/15)	-1.40	--	-4.35	--	-10.16	--	1.96	--	1.59	--
iShares MSCI ACWI	(3/15)	1.08	--	1.52	--	-3.34	--	6.31	--	5.53	--
American Funds New Perspective F2	(3/15)	0.83	49	-1.61	67	-1.69	27	8.11	13	7.96	9
<b>Idx: MSCI EAFE</b>		<b>-1.46</b>	<b>--</b>	<b>-4.42</b>	<b>--</b>	<b>-10.16</b>	<b>--</b>	<b>2.06</b>	<b>--</b>	<b>1.68</b>	<b>--</b>
<b>Idx: MSCI ACWI</b>		<b>0.99</b>	<b>--</b>	<b>1.23</b>	<b>--</b>	<b>-3.73</b>	<b>--</b>	<b>6.03</b>	<b>--</b>	<b>5.38</b>	<b>--</b>
Schroder Emerging Market Equity	(11/12)	2.32	46	5.42	55	-10.58	56	-1.38	51	-3.12	46
<b>Idx: MSCI Emerging Markets</b>		<b>0.66</b>	<b>--</b>	<b>6.41</b>	<b>--</b>	<b>-12.06</b>	<b>--</b>	<b>-1.56</b>	<b>--</b>	<b>-3.78</b>	<b>--</b>

Data Source: Morningstar, SEI Investments

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# COUNTY OF CONTRA COSTA

For Period Ending June 30, 2016

REIT EQUITY FUNDS											
Fund Name	Inception	3-Month		YTD		1-Year		3-Year		5-Year	
		Return	Rank	Return	Rank	Return	Rank	Return	Rank	Return	Rank
Nuveen Real Estate Secs Y		6.49	18	11.56	29	23.03	14	13.48	23	12.19	16
<b>Idx: Wilshire REIT Index</b>		<b>5.60</b>	--	<b>11.09</b>	--	<b>22.82</b>	--	<b>13.63</b>	--	<b>12.48</b>	--
BOND FUNDS											
Core Fixed Income Portfolio		2.51	38	5.81	13	6.02	11	4.06	25	4.05	30
Pimco Total Return Inst'l		2.07	72	3.90	85	4.31	65	3.48	61	3.71	49
Prudential Total Return Bond Fund Class I	(5/16)	3.25	4	6.57	4	6.56	3	5.28	2	5.21	2
<b>Idx: BarCap US Aggregate Bond</b>		<b>2.21</b>	--	<b>5.31</b>	--	<b>6.00</b>	--	<b>4.06</b>	--	<b>3.76</b>	--
<b>PIMCO High Yield Instl</b>	<b>(11/14)</b>	<b>3.32</b>	<b>76</b>	<b>6.12</b>	<b>62</b>	<b>1.92</b>	<b>13</b>	<b>4.18</b>	<b>16</b>	<b>5.39</b>	<b>22</b>
<b>ML US HY BB-B Constrained</b>		<b>4.61</b>	--	<b>7.90</b>	--	<b>2.13</b>	--	<b>4.62</b>	--	<b>5.86</b>	--
ALTERNATIVE FUNDS											
AQR Managed Futures	(7/13)	1.76	31	2.16	50	4.69	29	6.55	27	4.62	7
AQR Equity Market Neutral I	(2/16)	-1.71	69	0.26	55	12.94	1	--	--	--	--
Eaton Vance Glbl Macro Abs Ret	(7/13)	1.31	60	1.50	58	2.17	22	2.23	25	1.90	47
<b>Idx: Dynamic Alternatives</b>		<b>1.03</b>	--	<b>0.95</b>	--	<b>-2.53</b>	--	<b>0.86</b>	--	<b>-0.36</b>	--

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# COUNTY OF CONTRA COSTA

For Period Ending December 31, 2015

LARGE CAP EQUITY FUNDS													
Fund Name	Inception	2015 Return	2015 Rank	2014 Return	2014 Rank	2013 Return	2013 Rank	2012 Return	2012 Rank	2011 Return	2011 Rank	2010 Return	2010 Rank
Columbia Contrarian Core Z	(7/13)	3.02	9	12.92	31	35.73	17	18.67	10	-0.93	52	16.21	17
T. Rowe Price Growth Stock		10.85	4	8.83	65	39.20	12	18.92	14	-0.97	39	16.93	35
Harbor Capital Appreciation Instl		10.99	4	9.93	53	37.66	17	15.69	43	0.61	24	11.61	82
Loomis Sayles Value Fund	(7/11)	-4.19	58	10.76	48	35.54	14	19.70	4	-2.81	66	11.94	72
Dodge & Cox Stock	(10/14)	-4.49	62	10.40	54	40.55	2	22.01	2	-4.08	74	13.49	47
iShares Russell 1000 ETF		0.82	34	13.08	42	32.93	37	16.27	12	1.36	60	15.94	49
<b>Idx: Russell 1000</b>		<b>0.92</b>	--	<b>13.24</b>	--	<b>33.11</b>	--	<b>16.42</b>	--	<b>1.50</b>	--	<b>16.10</b>	--
MID CAP EQUITY FUNDS													
iShares Russell Mid-Cap ETF		-2.57	39	13.03	17	34.50	74	17.13	52	-1.67	42	25.25	73
SMALL CAP EQUITY FUNDS													
Columbia Small Cap Value II Z		-2.90	15	4.61	42	40.14	20	14.57	61	-2.39	30	25.64	52
<b>Idx: Russell 2000 Value</b>		<b>-3.83</b>	--	<b>4.22</b>	--	<b>34.52</b>	--	<b>18.05</b>	--	<b>-5.50</b>	--	<b>24.50</b>	--
T. Rowe Price New Horizons		4.50	7	6.10	19	49.11	10	16.20	22	6.63	2	34.67	12
<b>Idx: Russell 2000 Growth</b>		<b>-1.38</b>	--	<b>5.60</b>	--	<b>43.30</b>	--	<b>14.59</b>	--	<b>-2.91</b>	--	<b>29.09</b>	--
iShares Russell 2000 ETF		-4.33	31	4.94	55	38.85	76	16.39	47	-4.19	56	26.76	69
INTERNATIONAL EQUITY FUNDS													
Dodge & Cox International Stock		-11.35	98	0.08	9	26.31	8	21.03	16	-15.97	81	13.69	6
Nationwide Bailard Intl Eqs InSvc		0.86	24	-1.94	15	21.68	28	20.87	17	-15.58	74	11.85	32
MFS International Growth I		0.30	55	-5.10	58	13.84	79	19.71	31	-10.62	40	15.24	35
iShares MSCI EAFE Index Fund		-0.90	45	-5.04	78	22.62	19	17.22	41	-12.18	25	7.52	92
<b>Idx: MSCI EAFE</b>		<b>-0.81</b>	--	<b>-4.90</b>	--	<b>22.78</b>	--	<b>17.32</b>	--	<b>-12.14</b>	--	<b>7.75</b>	--
Schroder Emerging Market Equity	(11/12)	-12.68	37	-4.61	70	-2.28	54	21.73	19	-16.70	20	13.49	92
<b>Idx: MSCI Emerging Markets</b>		<b>-14.92</b>	--	<b>-2.19</b>	--	<b>-2.60</b>	--	<b>18.22</b>	--	<b>-18.42</b>	--	<b>18.88</b>	--
SPDR EURO STOXX 50 ETF	(6/14)	-4.26	84	-8.36	73	27.43	34	20.48	55	-16.42	48	-8.94	95
American Funds New Perspective F2		5.56	6	3.46	41	27.11	39	39.00	15	-7.39	44	13.01	46
MFS Global Equity R5		-1.34	48	4.08	33	27.93	34	34.00	4	-5.13	25	10.95	55
iShares MSCI ACWI		-2.39	46	4.64	34	22.91	54	54.00	30	-7.60	71	12.31	34
<b>Idx: MSCI ACWI</b>		<b>-2.36</b>	--	<b>4.16</b>	--	<b>22.80</b>	--	<b>16.13</b>	--	<b>-7.35</b>	--	<b>12.67</b>	--
REIT EQUITY FUNDS													
Nuveen Real Estate Secs Y		3.48	37	31.28	17	1.32	58	18.34	22	7.96	50	30.57	12
<b>Idx: Wilshire REIT</b>		<b>4.23</b>	--	<b>31.78</b>	--	<b>1.86</b>	--	<b>17.59</b>	--	<b>5.52</b>	--	--	--

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# COUNTY OF CONTRA COSTA

For Period Ending December 31, 2015

BOND FUNDS													
Fund Name	Inception	2015 Return	2015 Rank	2014 Return	2014 Rank	2013 Return	2013 Rank	2012 Return	2012 Rank	2011 Return	2011 Rank	2010 Return	2010 Rank
Core Fixed Income Portfolio		0.78	14	4.74	70	-1.40	41	5.42	69	8.41	5	--	--
Pimco Total Return Inst'l		0.73	15	4.69	71	-1.92	60	10.36	12	4.16	87	8.83	26
<b>Idx: BarCap US Aggregate Bond</b>		<b>.55</b>	<b>--</b>	<b>5.97</b>	<b>--</b>	<b>-2.02</b>	<b>--</b>	<b>4.21</b>	<b>--</b>	<b>7.84</b>	<b>--</b>	<b>6.54</b>	<b>--</b>
PIMCO High Yield Instl	(11/14)	-1.85	22	3.31	13	5.77	68	14.55	52	4.00	38	14.24	45
<b>Idx: Merrill Lynch US High Yield BB-B</b>		<b>-2.79</b>	<b>--</b>	<b>3.49</b>	<b>--</b>	<b>6.31</b>	<b>--</b>	<b>14.59</b>	<b>--</b>	<b>5.39</b>	<b>--</b>	<b>14.26</b>	<b>--</b>
ALTERNATIVE FUNDS													
Arbitrage I (Sold 11/15)	(7/13)	0.90	39	1.64	39	1.15	67	0.44	48	4.74	20	1.76	16
AQR Managed Futures	(7/13)	2.00	31	9.69	40	9.40	6	2.99	5	-6.37	29	0.00	0
Eaton Vance Gbl Macro Abs Ret	(7/13)	2.63	7	3.03	18	-0.24	58	4.11	79	-0.39	44	4.75	61
JPMorgan Research Market Neutral Instl	(7/13)	-3.61	74	3.38	25	2.26	56	4.51	9	-7.04	86	-0.90	36

Data Source: Morningstar, SEI Investments

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