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County Retirees' Group Cedes All Investment Decision Making

Finance: Salient Praised For Better Returns; Board Extends Contract to 2019

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The county's employee pension fund, which exceeds $10 billion as of June, is now totally controlled by its outside chief investment officer, Salient Partners of Houston.

In a move the San Diego County Employees Retirement Association's board first approved in May and officially adopted last month, it handed over decision-making on the fund's private market holdings — or the remaining 30 percent of the portfolio — to Salient.

The holdings include existing hedge funds and private equity funds. Salient already manages SDCERA's public portion of the portfolio, including publicly traded equity and bond funds.

Brian White, SDCERA's chief executive officer, said a vote taken last month extends the organization's contract with Salient by 21 months to 2019, and will result in an estimated cost savings of $9.75 million over the contract's term.

"In addition to cost savings, SDCERA also gains improved access to the support provided by a broad and deep talent pool at Salient Partners," White said.

As part of the new contract Salient said it intends to hire the three investment officers currently working at SDCERA to oversee the pension fund's private investments. Salient said it will open a local office here, White said.

The contract increased the management fees paid to Salient from 8 basis point to 10 basis points — or 0.008 to .001 percent — of the pension fund's total assets, and will result in SDCERA paying about $10 million annually compared with about $8 million as of last year, according to SDCERA reports.

Near Unanimous Board Support

In his presentation to the board, White lauded Salient's performance as an investment manager. Since the firm has managed the pension fund, starting in October 2009, "our returns have been 9.9 percent, net of fees," he said.

That return compared with the returns of a more traditional pension fund portfolio — with 60 percent stock and 40 percent bond allocations — of 9.2 percent in annual returns, White said.

Not everyone was thrilled with Salient's performance and the prospect of SDCERA shelling out an additional $2 million annually for management fees.

Dan McAllister, San Diego County's Treasure-Tax Collector, who has been on SDCERA's board of directors for 12 years, cast the lone dissenting vote in the 8-1 board decision on June 5.

"This is not a performane- based contract," McAllister said. "In the real world a contract like this would be based on performance."

"I've consistently voted against this contract and will continue to vote against this contract because I think there's a better way to do it," he said.

For SDCERA's most recent available fiscal year, which ended June 30, 2013, it had an annual return of 8.3 percent, compared with a return of 6.52 percent for the prior fiscal year. The fiscal 2014 results won't be available for another month, White said.

Changes in Investment Strategy

Starting July 1, as directed by SDCERA's board, Salient has been implementing a "risk parity" strategy that is intended to increase the flexibility of the fund to adapt to changes in the economy.

Among the changes the strategy entails are reducing the fund's allocation in equities, federal bonds and hedge funds; eliminating inflation-protected securities; and allocating funds for direct lending to small businesses.

White said Salient hasn't found managers yet for the direct lending part of the portfolio; it has allocated $10 million to $15 million to begin this strategy. Once managers are found, the total amount expected for this strategy would be $50 million to $75 million, or less than 1 percent of the total portfolio, he said.

When SDCERA's board considered a direct-lending strategy last year, consultants said the returns that could be obtained on the loans ranging from $20 million to $200 million to midmarket companies would be greater than the returns it was getting in more traditional investment vehicles.

Tom Warschauer, professor of finance emeritus at San Diego State University, said many public pension funds are moving to a contracted outside chief investment officer model because salaries paid by cities, counties and school districts generally can't match what investment strategists can earn in the private sector.

"The question is does increasing the salary really increase the return you might get," Warschauer said.