Deferred Compensation Plan
INVESTMENTS COMMITTEE REPORT 14-03

Date: September 29, 2014

To: Investments Committee

From: Staff

Subject: Investment Manager Search Finalist Reviews: Active Core Bond, Small-Cap Growth, and Small-Cap Value Equity

Recommendation:

That the Investments Committee:

a) Review additional information in consideration of the finalist funds for the Active Core Bond, Small-Cap Growth, and Small-Cap Value Equity mutual fund searches, and
b) Select a provider in each category to recommend to the Board for formal selection.

Background:

At its August 28, 2014 meeting, the Investments Committee reviewed the initial search conducted by the Plan's investment consultant, Mercer Investments Consulting ("Mercer"), for viable funds in the Active Core Bond, Small-Cap Growth, and Small-Cap Value Equity categories. Upon review, the Committee asked Mercer to report back with additional information on the funds identified as finalists in each category. Mercer indicated the secondary analysis would include more qualitative data on the funds. The Committee asked that the additional analysis also include information related to how the different funds would correlate to one another and/or with an existing underlying fund, as each selection would become a partial allocation of an overall Plan branded fund, and how they would perform in comparison to the benchmark for the asset class so that the benefit of including active components in the overall Plan branded fund could be identified.

Discussion:

Mercer has provided a detailed analysis of the finalist funds, which is attached to this report. At the Committee meeting, Mercer will walk the Committee members through the additional information for the purpose of finalizing a fund selection to the Board.

Following is a basic overview of the finalist funds in consideration:

ACTIVE CORE BOND

The Active Core Bond category makes up 50% of the underlying allocation for the DCP Bond Fund, an option in the Plan's core investment menu (the other half of the DCP Bond Fund is a fund passively managed by Vanguard). The estimated mandate size is $167 million.

Of twelve funds reviewed, the following firms manage funds identified as finalists for additional review:

1. Dodge & Cox Investment Managers
2. Loomis, Sayles & Company
3. TCW Group (MetWest)
4. Pacific Investment Management Company (PIMCO)

   ** PIMCO has provided correspondence to the Plan and has asked it be submitted to the Committee for consideration. It is attached to this report for the Committee's review.*

SMALL-CAP GROWTH & VALUE

Currently, the Plan offers one small-cap investment fund option within its core investment menu. This option is currently managed by State Street Global Advisors (SSgA) and is 100% passively managed. However, the Plan is seeking to re-brand the small-cap asset class fund and change the underlying allocations, as indicated in the Plan's Investment Policy and as previously discussed and approved by the Board of Deferred Compensation Administration. Through this mutual fund selection process, the DCP Small-Cap Fund will soon become allocated to 34% passive, 33% growth, and 33% value. The estimated mandate size is $100 million.

Of 14 small-cap growth fund providers reviewed by the Committee, the following firms manage funds that were identified as finalists:

1. The Hartford Mutual Funds (HartfordSCG)
2. The Hartford Mutual Funds (HartfordSmCo)
3. Eagle Asset Management

And, of 11 small-cap value fund providers reviewed, the following firms manage funds that were identified as finalists:

1. William Blair & Company
2. Federated Investors
3. American Beacon Advisors
4. Dimensional Fund Advisors (DFA)

Upon the Committee's review of the finalist funds, staff recommends the Committee select one provider for each category to recommend to the Board for formal selection.

Submitted by: ______________________________
Esther Chang

Approved by: ______________________________
Steven Montagna

ATTACHMENT

PIMCO

Mr. Steven Montagna
Employee Benefits Division Chief
City of Los Angeles Deferred Compensation Plan
200 N. Spring Street #867
Los Angeles, CA 90012

September 23, 2014

Dear Steven,

We deeply appreciate the inclusion of the PIMCO Total Return Fund as one of twelve finalists in the City of Los Angeles Deferred Compensation Plan's search for the Active Core Bond component of the DCP Bond Fund. We hope you agree that your participants have been well served by the Total Return Fund over the last seven years and we aspire to continue to deliver the unique benefits of PIMCO's active management to your Plan. As you evaluate future use of the Total Return Fund, we would like to emphasize a few key points that we believe are very important to consider.

First, we strongly believe that allocations to fixed income in participant directed plans should provide portfolio stability. This is particularly true during stock market corrections since simultaneous losses in a bond portfolio may discourage behavior that is in the best long-term interest of participants, such as contributing to a deferred compensation account.

Accordingly, when evaluating the track record of an active bond manager, we believe a sponsor should consider:

- The absolute level and timing of losses
- The correlation of excess returns (alpha) to equity market returns

On both measures, the data suggest that the excess returns of many managers rely primarily on strategies and sectors (such as credit) that are highly correlated to the equity market. The data also demonstrate that PIMCO pursues a substantially different approach thereby achieving better drawdown and equity correlations statistics:

Manager	**Drawdown**			**Correlation*** **
	Max 12-Month Drawdown (%)	**Period Ending**	**12 Month Equity Return****	
PIMCO Total Return Fund	-3.62%	10/31/1994	+3.87%	0.24
Intermediate Term Bond*	-8.13%	11/30/2008	-38.09%	0.63

**Intermediate Term Bond refers to Morningstar's Intermediate Term Bond Category (which includes the PIMCO Total Return Fund as well as other funds under consideration by the Plan).*
***12 month return of the S&P 500 ending at the specified drawdown period.*
****Average correlation of rolling five year excess returns (net of fees) of the PIMCO Total Return Fund to the returns of the S&P 500 from 8/31/2004 to 8/31/2014.*

Second, PIMCO's investment philosophy emphasizes consistency through the use of highly active and diverse strategies. PIMCO's substantial resources allow the Total Return Fund to pursue global opportunities unavailable to benchmark constrained investors and other active managers. We believe this approach produces more consistent results for your participants. In fact, the Total Return Fund has outperformed its benchmark on an after fee basis in 97% of rolling quarterly three year periods since the Fund's inception. We have found this level of reliability to be highly valued by plan participants and we believe is another reason that the PIMCO Total Return Fund effectively complements passive allocations.

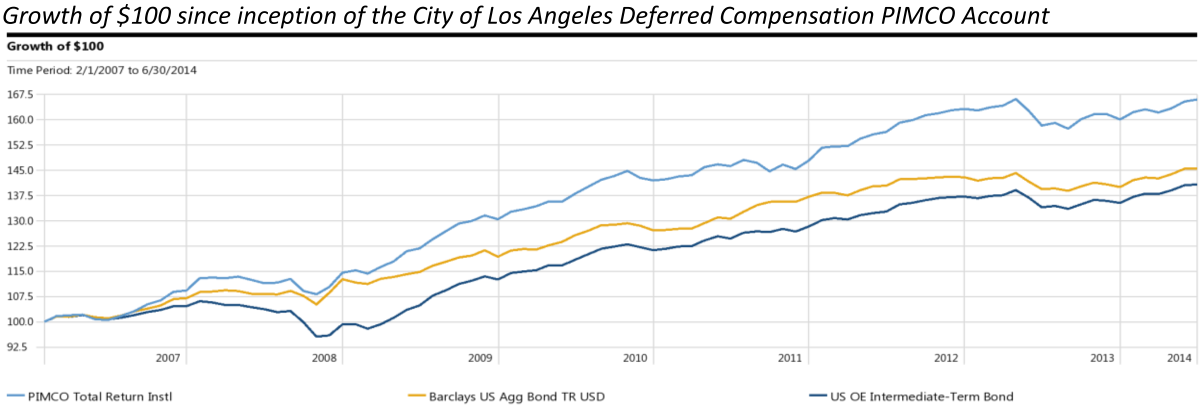
The PIMCO Total Return Fund is also unique for the long-standing stability of its portfolio management team:

- Bill Gross, PIMCO's Chief Investment Officer, has led the Total Return Fund since the Fund's inception in 1987
- PIMCO's Deputy Chief Investment Officers (DCIOs), who collaborate on Total Return and other strategies, have a combined 70 years of PIMCO experience
- PIMCO's other senior portfolio managers average 19 years of industry experience and 10 years at PIMCO.

While PIMCO has experienced recent change in its business leadership, the investment leadership for the PIMCO Total Return Fund remains strong and stable and is well positioned to deliver attractive results for your participants.

The evaluation criteria of your Investment Policy Statement appropriately focus on longer term results. We also believe it is important to carefully evaluate short-term periods of strong performance. The last five years have been remarkably positive for credit intensive sectors of the bond market. The Total Return Fund has benefitted from this environment but not to the same degree as other managers who maintain larger, structural allocations to credit. If history is any guide, these dynamics will likely revert to long-term averages, potentially creating a landscape that may well reward PIMCO's more diversified approach. In short, we believe the PIMCO Total Return Fund will continue to preserve and grow the savings of your participants as it has done since its inclusion in your Plan:

Growth of $100 since inception of the City of Los Angeles Deferred Compensation PIMCO Account



Finally, we believe serving plan participants extends beyond portfolio management expertise. The City of Los Angeles has led the broader deferred compensation community by implementing a range of thoughtful innovations. PIMCO is fortunate to possess industry leading presence in deferred compensation and defined contribution plans, and we feel uniquely positioned to partner with you in the long-term evolution of your Plan. Whether it is through the provision of innovative thought leadership on plan design; actively supporting your participant communication objectives; or any other activity that is of interest to the Plan; we hope to provide PIMCO's unique and substantial resources for the benefit of the Plan and your participants.

In 2007, the City of Los Angeles Deferred Compensation Plan selected the PIMCO Total Return Fund after careful consideration of a range of well qualified providers. We have deeply valued your trust in us and take pride in the results we have delivered to your participants. We very much hope to serve you and your participants for many years to come.

If we may be of assistance in any way, please do not hesitate to let us know.

Sincerely,

Matt Clark

Matt Clark
Senior Vice President
PIMCO