Bay Area
Impact Investing Initiative

BAIII Custom Equity Portfolio **March 2018 Update**

The model portfolio developed in 2011, and still managed by Aperio Group of Sausalito, California, has tracked the returns that would have resulted from the instructions we designed for the portfolio program: to develop an optimal portfolio that maximizes the ESG score unique for our mission, and minimizes the tracking error to the benchmark, given various concentrations of local companies.

This process was described in a working paper published and posted by the Federal Reserve Bank of San Francisco in December 2012. The optimal portfolio, described in the table below, has a 4X overweighting in Bay Area headquartered companies versus the benchmark Russell 3000, a 30% improvement in the custom ESG score, and is expected to have a less than 2% tracking error.

Portfolio Characteristics:

2011 research results	**BAIII-UWBA-Aperio model**	Russell 3000
Universe	1,982	2,940
Standard Deviation	20.49	20.43
Tracking error vs Benchmark	1.64	0.00
Model UWBA ESG score	60	46
Bay Area companies %	75	19
Number of holdings	210	2,940
Avg Market Cap, $Billions	$89.5	$87.9

The chosen portfolio has produced the following performance results:

Calendar Year	**BAIII-UWBA-Aperio model**	Russell 3000
2011	**1.56%**	1.01%
2012	**20.95%**	16.37%
2013	**33.38%**	33.46%
2014	**16.29%**	12.54%
2015	**0.82%**	0.47%
2016	**13.99%**	12.64%
2017	**27.43%**	21.97%
Inception Cumulative	**179.04%**	141.90%
Inception Annualized	**15.79%**	13.45%
Standard Deviation	12.65%	12.33%

Using BARRA-like factor attribution analysis, and since the optimizing instructions kept the portfolio's sector weightings, industries, and market timing neutral to the benchmark, the portfolio's strong relative performance of +2.33% is due almost entirely to Asset Selection (2.15%). Asset selection is driven by the instructions we set: maximize the ESG score subject to keeping the tracking error to around 2% using the Bay Area focused universe we developed. The active positive return contributed to an actual tracking error of 2.29%.

> Portfolio Manager's 12/31/17 report from Aperio:
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> The strategy trailed the Russell 3000 in Q4 (5.72% vs. 6.33%) but outperformed for the full calendar year (27.43% vs. 21.07%).
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> Key takeaways:
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> - By optimizing the portfolio to track the Russell 3000 index, the strategy has relatively low factor exposures and corresponding contributions from factors to the overall return difference.
> - As expected, the primary driver of return difference is asset selection (i.e., that portion of return which cannot be explained by factor exposures).
> - The majority of asset selection active return comes from over-weighted assets as opposed to benchmark assets not held.

- The top 3 contributors to asset selection active return were overweight positions in Chevron, Tesla and Andeavor, which added a total 0.96% to the return difference.

BAIII Multi-Manager Public Equity Portfolio

In order to reduce single strategy/single style risk, the BAIII multi-manager public equity portfolio would have three separate strategies:

- BAIII/Aperio enhanced index-like custom portfolio
- HIP Investor
- BlackRock Russell 3000 index

HIP Investor www.HIPInvestor.com

HIP Investor, a Bay Area based investment firm, provides this active strategy that integrates ESG factors through its unique fundamental analysis and HIP ratings systems.

> The components of the HIP Rating include Products & Services, Management Practices and the 5 pillars of Health, Wealth, Earth, Equality and Trust, which are derived from measures such as Customer Satisfaction, Employee-to-CEO Pay, Carbon Emissions, Gender Diversity and Lobbying Expenditures.
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> The Fossil-Free HIP 100 Exclusion portfolio excludes from the S&P100 companies in fossil energy, chemicals, materials, banking and high-negative-impact firms, and reweights those remaining component companies based on the same systematic analysis used in the HIP100.

	2017	**2016**	**2015**	**2014**	**Ann incep**	**Cum Incep 1/5/12-12/31/17**
HIP 100 Fossil Free (gross of fee)	23.07%	9.52%	2.77%	17.50%	16.03%	144.05%
S&P 100 Index ETF	21.83%	11.03%	2.42%	12.56%	14.94%	130.61%

BlackRock www.blackrock.com/corporate

The BAIII multi manager equity strategy also includes a passively managed index fund offered by BlackRock that incorporates active corporate engagement to enhance long term shareholder value and to vote for sustainable environmental, social and governance practices. With this combination of portfolio management strategies, we have a high degree of confidence that we can achieve both market rates of return at market levels of risk, and have a positive impact on our local economy.

Jan 1, 2011 to Dec. 31, 2017	Annualized performance	Cumulative performance	Standard Deviation
Bay Area UWBA Equity model *Enhanced index with ESG*	15.79%	179.0%	12.63%
HIP Fossil Free 100 *Active management + ESG*	14.65%	144.0%	9.62%
BlackRock Index Russell 3000 *Passive with corp engagement*	13.45%	141.5%	12.33%
BBACAX (cap weighted) Bloomberg Bay Area Index *Universe of Bay Area companies*	15.1%	167.4%	13.62%

The BAIII Equity Fund, with these three strategies equally weighted in a multi-manager portfolio, we could have experienced an annualized return (since inception) of 15.09%, beating the Russell 3000's return of 13.45% by 150 basis points.

> *Note: the Blomberg Bay Area index (BBACAX) is a cap weighted index formed in partnership with the San Francisco Chronicle in 2001 to track nearly 400 companies headquartered in the Bay Area. It served as the basis for the universe of Bay Area companies. More than half of its value in 2011 was represented by five stocks: Apple, Chevron, Google, Oracle and Wells Fargo.* [*www.bloomberg.com*](http://www.bloomberg.com)

Impact Assessment

One key driver to positive social and environmental impact that investors have with a public equity portfolio is to engage with the management of the companies whose shares they own. Collaboration with other large investors on ESG related issues, particularly with our focus on the companies headquartered in the Bay Area, who are employing hundreds of thousands in our communities, is the most effective way to influence long term corporate behavior and transparency. In the Bay Area, we have the opportunity to encourage corporate management in areas of diversity (for Silicon Valley companies), governance and management practices (Wells Fargo), and for carbon disclosures and environmental risks (Chevron, Andeavor), just to name a few.

Because we are over-weighted in companies that are headquartered in the Bay Area, we would have a 'louder' voice when we vote our proxies and in engaging with regards to corporate policies and management issues. We are seeking to protect the environmental ecosystem of the Bay Area and to work together minimize our environmental impact locally. We are looking to support the employees of these local companies who live. work and commute in the Bay Area. Most importantly, given our fiduciary standards and with this combination of active, passive and enhanced portfolios, we can be comfortable that we can reasonably expect market-like risk and returns over time.

In December 2012, Lauryn Agnew published the research study “Impact Investing for Small, Place-Based Fiduciaries” for the United Way of the Bay Area. You can download the paper here or view it on the Federal Reserve’s website.

BAIII Article: *Place based impact investing: How to invest in your own backyard’:*
https://cornerstonecapinc.com/place-based-impact-investing-how-to-invest-in-your-own-backyard/
This is a link to the short article in the Cornerstone Capital’s monthly magazine on “Proximity” from December, 2016, that summarizes the BAIII concept and recommendations.