BOARD OF INVESTMENT TRUSTEES

MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS

REBALANCING POLICY

S:\POLICIES\Rebalancing Policy Final 1110.doc
Amended:
November 19, 2010
December 6, 2002

MONTGOMERY COUNTY EMPLOYEES' RETIREMENT SYSTEM
REBALANCING POLICY

The strategic objective of the Board's rebalancing program is to maintain the Fund's asset allocation targets while limiting unintended drift from the target weights caused by market movements and individual investment manager performance. Significant movements from the long term asset class policy weights will alter the expected return and risk of the System's portfolio. The most efficient rebalancing method minimizes the tracking error related to drifts from the target allocation at the lowest possible transaction cost.

Strategic Asset Allocation and Ranges

The Board invests according to a strategic asset allocation policy that identifies the percentage of the System's assets to be invested in each asset class. The desire to maintain the constant strategic mix must be balanced with the cost of portfolio rebalancing. In establishing its risk tolerance, the Board considers its ability to withstand short and intermediate term characteristics of various asset classes, focusing on balancing risk with expected return. One essential component of a strategic asset allocation policy is the development of and use of rebalancing ranges for each target allocation allowing for fluctuations that are inherent in marketable securities. The Board has established tactical ranges within which each asset allocation is allowed to move without provoking any rebalancing transactions. The allowable ranges shall guide asset class and manager rebalancing decisions by the Executive Director and/or the Board. The rebalancing ranges established by the Board are shown below:

Total Fund

	Target Allocation	**Allowable Ranges**
Domestic Equities	17.5%	14.5 to 20.5%
International Equities	15	12 to 18
Emerging Market Equities	2.5	1 to 4
Private Equity	10	7 to 13*
Total Equity	**45**	**40 to 50**
Core Fixed Income & Cash	2.5	1 to 4
Long Duration Fixed Income & Opportunistic	17.5	14.5 to 20.5
High Yield Bonds	10	7 to 13
Total Fixed Income	**30**	**25 to 35**
TIPS	10	7 to 13
Private Real Assets	10	7 to 13*
Commodities	5	2 to 8
Total Real Assets	**25**	**20 to 30**

*Both Private Equity and Private Real Assets target allocations will be reached over a long time horizon, therefore, funds to be invested in these asset classes may temporarily reside in other asset classes. The target allocation and allowable ranges of the affected asset classes may be temporarily altered to account for this.

Managers

Within all asset classes there is “misfit” risk arising from operating under broadly defined benchmarks for the asset class while employing managers who pursue narrower strategies in implementation. The Board structures managers within each asset class through a process which considers return, tracking error and factor risks, as well as qualitative assessments, to identify the optimal allocation to each manager. Similar to the overall Fund, market movements and individual manager performance will cause periodic deviations in actual manager weights from their target allocation. To minimize the tracking error related to these deviations, the Board establishes a rebalancing range of 90% **-** 110% of each manager’s target allocation.

Monitoring Requirements

Board Staff will monitor the Fund’s total allocation by manager and asset class on a daily basis through the custodian bank’s risk compliance system. A daily asset allocation worksheet will be maintained reflecting the current allocation of each asset class and manager compared to the target allocation. Any breach of the allowable ranges will be reported to the Staff Investment Committee along with a recommendation for correction. The Executive Director will approve the transfer of funds to accomplish the rebalancing initiative.

Each portfolio manager will monitor the Fund’s sub asset class allocation including style, sector, market capitalization, credit rating and duration and may recommend rebalancing to the Staff Investment Committee to minimize unintended benchmark drift.

Trading Procedures

The Board directs the Executive Director to take all actions necessary, within the confines of this policy, to act prudently to rebalance assets to within target ranges in a timely and cost effective manner when actual weights are outside the target range. The first tool used to achieve the required rebalancing shall be regular cash flows such as contributions, benefit payments, capital calls and other cash requirements. If cash flows are not sufficient to achieve the required rebalancing, the Board authorizes the Executive Director to transfer assets, by purchase or sale, between managers to return the asset allocation to the midpoint between the upper or lower level of the allowable range and target allocation. Movement from one manager to another will be based on the relative over/underweight of the manager to the manager’s target allocation, liquidity characteristics, and current market conditions.

Any manager may be increased or decreased to achieve the rebalancing objective, however, given the illiquidity of private equity and private real assets, it may not be optimal to automatically require rebalancing for these asset classes should an allowable range be exceeded. In the event that targets for these two asset classes are exceeded, Staff will initiate discussions with the Board as to the most efficient means of rebalancing which may include adjusting the annual commitment pace for the asset class. Additionally**,** the Board authorizes the Executive Director to invest funds that would otherwise be invested in an underweight manager in a passive vehicle to acquire the desired market exposure.

The Executive Director will bring to the Board recommendations beyond the procedures outlined, including the use of derivatives, when appropriate.

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