WURTS ASSOCIATES
INSTITUTIONAL INVESTMENT CONSULTANTS

MEMORANDUM

To: Board of Trustees, Fresno County Employees' Retirement Association

From: Jeffrey MacLean, CEO and Senior Consultant

Date: April 25, 2013

RE: Common Sense Watch Recommendation

In January 2013 Common Sense announced a change in the investment process, portfolio manager departures and new hires. Wurts & Associates recommends placing Common Sense on Watch Status for these organizational changes.

Background
Common Sense was funded in December 2009, managing a long/short equity-focused hedge fund of fund. As of December 31, 2012 Common Sense managed $48 million or 1.4% of FCERA assets. It is one of two hedge fund of funds managers for FCERA. Common Sense has lagged its benchmark by 150 basis points over the three years since inception and ranked just below median in its universe.

Organizational Changes
Common Sense has experienced a number of organizational changes during the first quarter 2013.

1. The firm's investment process was modified to become more of a team/consensus approach rather than having portfolio managers assigned to specific funds.
2. Two portfolio managers – Jonathan McGowan and Scott Kelly – resigned from the firm's long-biased funds.
3. Over the past year, the firm added Rex Kim, formerly Director of Hedge Fund Research at CTC Consulting, and Mike Wietecki, formerly Chief Compliance Officer and Assistant General Counsel at Whitebox Advisors. Mr. Kim joined the firm as a research partner, while Mr. Wietecki joined as a compliance partner. Patrick Manning also joined the firm as a research analyst.
4. Subsequently, Common Sense announced that Matthew Woodbury joined the firm as a Partner and Portfolio Manager in March 2013. Previously, Mr. Woodbury was a Director at UBS in the Alternative Investment Solutions Group.

Performance
Wurts & Associates discussed Common Sense's underperformance at the December 2012 meeting, and our Manager Research Group met with the Common Sense team soon thereafter.

Common Sense had a poor 2012, lagging its benchmark by 770 basis points. The manager attributes underperformance to the rally in low quality stocks. Common Sense believes that higher quality companies are poised to outperform given significant fundamental problems globally. Government intervention has also been a headwind by "defeating fundamental outcomes" and making it more difficulty to produce alpha on the short side. They expect to outperform at the peak of a corporate profit cycle.

Conclusion

The process change and portfolio manager departures are significant. Common Sense is reverting back to the team/consensus approach which had been their process for 18 years prior to the 2008 transition to the "co-portfolio leads" approach. They cited better utilization of core strengths and abilities, minimizing potential manager bias, better adherence to portfolio disciplines and enhancing teamwork as drivers of the process change, presumably because the "co-leads approach" did not work out as expected. Regarding the portfolio manager departures, it is our understanding the firm ran into "team dynamic" problems which were aggravated by poor performance in their short-biased strategies.

Wurts & Associates recommends Watch Status for Common Sense. We will review the role of Common Sense in the FCERA portfolio at the conclusion of the Asset Liability Study.