

INVESTMENT ADVISORY COUNCIL
Tuesday, November 10, 2009

MEETING NO. 371

Members present:

Michael Freeman
David (Duke) Himmelreich
Stanley (Bud) Morten
William Murray
Denise L. Nappier, Treasurer*
Sharon Palmer
David Roth**
Joseph (Joe) D. Roxe, Chairman
Carol Thomas
Peter Thor***

Absent:

Thomas Barnes
Thomas Fiore, representing Robert Genuario

Others present:

Howard G. Rifkin, Deputy Treasurer
Linda Hershman, Assistant Deputy Treasurer/Chief of Staff
M. Timothy (Tim) Corbett, Chief Investment Officer
Lee Ann Palladino, Deputy Chief Investment Officer
Wayne Hypolite, Executive Assistant
Catherine LaMarr, General Counsel
Shelagh McClure, Director of Compliance
Christine Shaw, Director of Government Relations
Linda Tudan, Executive Assistant
Winifred (Winnie) Scalora, Administrative Assistant

Guests:

Joseph Barcic, Mercer Investment Consulting
Jaeson Dubrovay, New England Pension Consultants
David Gabrielson, Ounavarra Capital, LLC
Harvey Kelly, Leumas Advisors
Louis Laccavole, SOC Teachers' Retirement Board
Jacqueline Lyons, State Street Bank & Trust
Cynthia Steer, Rogerscasey
Dominic Williams, Service Employees International Union

With a quorum present, Chairman Joseph Roxe called the Investment Advisory Council ("IAC") meeting to order at 9:00 a.m.

Approval of Minutes of the September 9, 2009 IAC Meeting

Chairman Roxe asked for comments on the Minutes of the September 9, 2009 IAC meeting. **There being no comments, a motion was made by Michael Freeman, seconded by Carol**

*Arrived at 10:11 a.m.

**Arrived at 9:40 a.m.

***Arrived at 10:45 a.m.

Thomas, that the Minutes of the September 9, 2009 IAC meeting be accepted as drafted. The motion was passed unanimously with the exception of Sharon Palmer who abstained due to her absence from the meeting.

Approval of Minutes of the October 14, 2009 IAC Meeting

Chairman Roxe asked for comments on the Minutes of the October 14, 2009 IAC meeting. Ms. Thomas noted that the word “favorable” should be changed to “favorably” in the last sentence of the Domestic Equity Brokerage Program Report within the minutes. **There being no other comments, a motion was made by Mr. Freeman, seconded by Ms. Thomas, that the Minutes of the October 14, 2009 IAC meeting be accepted as drafted with the above-mentioned change. The motion was passed unanimously with the exception of Ms. Palmer and William Murray who abstained due to their absence from the meeting.**

CRPTF Final Performance as of September 30, 2009

M. Timothy Corbett, Chief Investment Officer (“CIO”), provided an update on the capital market environment and its impact on the performance of the Connecticut Retirement Plans and Trust Funds (“CRPTF”). He began by commenting on the economic news since the last IAC meeting. Mr. Corbett stated that the Gross Domestic Product grew at an annualized rate of 3.5% during the third quarter of 2009, which was the first increase in five quarters and indicated an end to the recession. Secondly, Mr. Corbett stated that U.S. unemployment rose to about 10.2% in October, 2009, which was near the level of the post World War II high of 10.8% that was reached in December, 1982. He added that most forecasters were predicting that unemployment would exceed that level over the next several months. Mr. Corbett noted that he believed consumers would not go back to their previous pattern of spending given high unemployment rates, and, therefore, economic growth would be relatively anemic over the next several years. He then discussed risks to economic growth over the near and long term, including those risks posed by the residential and commercial real estate markets, and the long term effects of fiscal and monetary stimulus. Mr. Corbett stated that in managing the CRPTF portfolio, it was important to be cognizant of these near-term and long-term risks.

Regarding the CRPTF’s performance for the quarter ended September 30, 2009, Mr. Corbett reported that seven of the 14 Plans and Trusts outperformed their benchmarks, five underperformed their benchmarks, and the remaining two do not have benchmarks. He added that six of the Plans and Trusts that outperformed during this period also outperformed over the last seven years. Mr. Corbett stated that the outperforming Plans and Trusts shared two characteristics: lower absolute returns, roughly plus or minus 8% during the third quarter of 2009 and ranging from 5.5% to 6% over the seven-year period; and typically included only public domestic equity and fixed income. He said that the underperforming Plans and Trusts also shared two characteristics: higher absolute returns ranging from 10% to almost 12% for the quarter and plus or minus 7% over the last seven years; and portfolios that included international and emerging market equities, private equity and real estate exposure. Mr. Corbett stated that the international and emerging market equity exposure provided the highest absolute returns while private equity and real estate underperformed over these periods.

Mr. Corbett then provided some performance highlights for the various funds but noted that in-depth attribution analysis would be provided in the reports for the third quarter of the 2009 calendar year at the next IAC meeting. In terms of total returns, he reported that the CRPTF gained 11.5% for the quarter ended September 30, 2009 and almost 16% year-to-date. Mr. Corbett reported that for this period the portfolio was up to \$22.4 billion, up from \$18 billion as of February 28, 2009. He noted that stock market indices had risen dramatically since bottoming out in March, 2009. Also, he noted that investment grade credit spreads tightened from 6% to less than 2.5%, and high yield credit spreads tightened from over 20% to under 8% over this time period.

In terms of managers' performance, Mr. Corbett reported that five of the eight public funds outperformed their benchmarks for the quarter ended September 30, 2009 including: the Developed Markets International Stock Fund, Emerging Markets International Stock Fund ("EMISF"), Core Fixed Income Fund, Emerging Market Debt Fund ("EMDF") and Liquidity Fund ("LF"). He reported that the High Yield Bond Fund, Inflation Linked Bond Fund and the Mutual Equity Fund ("MEF") underperformed their benchmarks; and over the longer term, about 50% of the public managers outperformed their benchmarks. Mr. Corbett said that the Private Equity Fund and the Real Estate Fund continued to underperform and there would be further discussion on these funds at the next IAC Meeting.

In response to Chairman Roxe's comment that the MEF underperformed its index during all measured periods, Mr. Corbett stated that the portfolio was being restructured. He said that the 130/30 strategies, which were added this year, and the Small/Mid Cap manager search that was currently underway should help close the performance gap. Discussion continued about the EMISF and EMDF portfolios, the LF's cash balances and whether managers added value. Mr. Corbett noted that there would be further discussion on value added from active management at a future meeting.

Update on the Cash Flow Report for the Teachers' Retirement Fund and State Employees' Retirement Fund

Chairman Roxe stated that the Cash Flow Report would be presented at the December 9, 2009 IAC Meeting.

Consideration of Recommended Structure Review for the Alternative Investment Fund

Lee Ann Palladino, Deputy CIO, began her comments by providing a brief history about the CRPTF's relationship with the co-consultants, New England Pension Consultants ("NEPC") and Rogerscasey. She introduced Jaeson Dubrovay, Senior Consultant of NEPC, and Cynthia Steer, Managing Director of Rogerscasey.

Ms. Palladino stated that the basic foundation of the Alternative Investment Fund ("AIF") was in place through the inclusion of the AIF guidelines in the Investment Policy Statement ("IPS"). However, she added that the AIF was not typical nor like any of the CRPTF's other funds and the focus of today's discussion surrounded the major differences and the AIF's role within the

CRPTF. Ms. Palladino said that much time and effort had been placed in properly entering the market for alternatives, with the understanding for the necessity to proceed cautiously and conservatively. She further stated that she would demonstrate that all requirements of the IPS would be addressed with respect to the AIF. Ms. Palladino said that, in particular, the Treasurer must consult with the IAC on five areas including: structure, deployment of assets, risk management, the search process and the timeline.

Ms. Palladino stated that the objective of the AIF was to reduce volatility of the CRPTF and to help hedge against the ramifications of inflation or deflation. She then presented recommendations stemming from the AIF structure review which included a dual track approach. Regarding the structure, Ms. Palladino said that one track was to invest in Absolute Return Strategies (“ARS”) to reduce volatility for the CRPTF, and the second track to invest in Real Assets was to protect the CRPTF against short-term and long-term inflation and deflation. Regarding asset deployment, she said that the allocation for the AIF was up to 8%, but 5.6% would be initially invested and paced over up to a two-year period, dependent upon the market conditions. Ms. Palladino discussed at length the risks associated with the AIF, and said that the CRPTF addressed risk management by: 1) adhering to the risk parameters outlined in policy, 2) the formulation of an enhanced risk management function under the duties of the Deputy CIO, and 3) creation of a risk committee, which included the CIO, deputy CIO, principal investment officers (“PIO”) and other operational and risk staff to oversee risk of the AIF and CRPTF. Finally, she stated that the search and timeline would be presented as a separate agenda item.

Mr. Dubrovay then presented an overview of ARS. He focused on what absolute return funds are, CRPTF’s role as an investor, and the risk and return potential of investing in these funds. Finally, Mr. Dubrovay presented the implementation plan. He stated the initial investment in ARS would be through fund-of-fund vehicles to create a core of diversified managers and strategies which would meet the objective of reducing overall risk to the CRPTF.

Ms. Steer provided a discussion on Real Assets. She began by providing an introduction to real assets in the context of inflation and deflation. Ms. Steer defined real assets noting they were physical or identifiable with an intrinsic value and she provided several examples. Finally, she discussed implementation for the CRPTF, which would include a diversified portfolio of real assets and specialized strategies to protect the CRPTF from both unexpected inflationary stocks and long-term inflation trends.

IAC members then engaged in a lengthy discussion regarding the AIF. In response to Ms. Thomas’ question, Ms. Palladino stated that risk reporting on the AIF would be done on a quarterly basis. She also responded to several questions posed by Mr. Roth about why investments would initially be done within a fund-of-fund structure and reiterated the need to begin with a conservative approach; and she noted that a PIO would be hired to oversee the AIF. Ms. Palladino clarified that the terminology of hedge funds versus ARS could be used interchangeably, and that the IPS identified these strategies as ARS. There was continued discussion about risk for the AIF and why the volatility should be somewhere between that of fixed income and equities, and the level of resources and expertise to evaluate these risks. In response to IAC members’ questions about risk, Mr. Dubrovay stated that the main risks of

investing in an absolute return fund directly included process risk, which is a full understanding of the implementation of the investment strategy, and exposure risk for the AIF. He stated that in order to mitigate these risks, diversification was key. There was further discussion about commodities, the current economic climate, modeling and the expected rate of return for ARS.

Chairman Roxe commented on the lack of transparency of fund-of-funds. Treasurer Nappier stated that in conjunction with the outside consultants, who have significant back office staff and expertise, the OTT staff and an accounting consultant, risk could be controlled. Both Ms. Steer and Mr. Dubrovay confirmed that their back office capability would be sufficient to provide the CRPTF adequate transparency on the fund-of-funds investments. She further commented that the OTT planned to invest in funds that could be understood and monitored. Discussion continued about liability, transparency, risk management and the ability to safeguard against fraud; and it was established that consultants were fiduciaries and insured for liability.

Consideration for the Search Process for the Alternative Investment Fund

Ms. Palladino presented project plans, timelines and evaluation/selection criteria for the two AIF manager searches: ARS and real assets. She stated that the searches would be conducted on a competitive basis utilizing the expedited search process by which the OTT primarily considered managers from its co-consultants' universe databases, and the searches would be conducted simultaneously. Ms. Palladino said that the first search would identify absolute return managers to create a core holding of diversified strategies designed to reduce correlations with traditional CRPTF assets and reduce overall portfolio volatility; and the second search was for an allocation to real assets, which would serve to help protect the CRPTF from the threat of inflation and the associated reduction in market value on many traditional assets. She elaborated on the screening and selection criteria, noting the high level of focus on risk management. Mr. Roth requested that the due diligence questionnaires for each consultant be emailed to the members of the council. Chairman Roxe requested an update on the process at the next IAC meeting.

Chairman Roxe then asked for a motion to endorse the Search Process for the two AIF money managers. **Ms. Thomas entered a motion to move forward with this search. David Himmelreich seconded the motion. The motion was passed unanimously.**

Consideration for the Search Process for an Accounting Consultant

Ms. Palladino provided a project plan, timeline and evaluation/selection criteria for an accounting consultant for Pension Fund Management ("PFM"), which would be conducted through a competitive request-for-proposal search. She said that this type of consultant retention was new to the CRPTF and that the OTT never had a dedicated accounting consultant firm to provide advice with respect to accounting issues pertaining to the CRPTF investments. Ms. Palladino said that the OTT's goal was to retain one or more firms to provide expert guidance with the growing number of limited partnership investments, to assist with general and forensic accounting and tax-related issues. Finally, she stated that while these firms would be utilized sparingly, the availability of outside resources would be dedicated to ensure that PFM had the appropriate level of transparency in and monitoring of the CRPTF's investments. Ms. Palladino said that

consultants with expertise in general accounting, forensic accounting, due diligence and tax-related issues were being included in the search process. Discussion ensued about the types of firms and expertise that the OTT was seeking for due diligence and ongoing monitoring purposes.

Chairman Roxe then asked for a motion to endorse the Search Process for the Accounting Consultant. **Ms. Thomas entered a motion to move forward with this search. Ms. Palmer seconded the motion. The motion was passed unanimously.**

CRPTF Sudan Initiative Report

Shelagh McClure, Director of Compliance, provided a report on the CRPTF Sudan Initiative. She began by citing Connecticut's Sudan statute, Conn. Gen. Stat. Section 3-21e. Ms. McClure then reported that Treasurer Nappier decided to take action and divest CRPTF funds from and prohibit future direct investment in the following four companies: Malaysia International Shipping Corporation, ("MISC Bhd"), a subsidiary of Petronas; CNPC, a subsidiary of China National Petroleum Company; Sinopec Shanghai, a subsidiary of China Petrochemical Corp. and Dongfeng Motor Corporation ("Dongfeng"). Ms. McClure stated that Treasurer Nappier had already divested and prohibited investing in affiliates of the first three companies listed above. She stated that Dongfeng, the fourth of these companies, sold vehicles to the Sudan military. Treasurer took action at the end of September, 2009; and Dongfeng was the only company that the CRPTF held shares in at that time so the managers were directed to divest and/or not hold shares of these companies until otherwise directed by the Treasurer. Ms. McClure said all companies and the federal government were informed of this action.

Chairman Roxe commented on Chinese investing within Africa.

Other Business

Chairman Roxe invited IAC members to submit agenda items for the December 9, 2009 meeting. David Roth stated that he had met with Mr. Corbett and within the next couple of months he would work with Mr. Corbett to lead a discussion on the CRPTF's core investment beliefs. Chairman Roxe stated that due diligence for selecting AIF managers and risk management for ARS would be discussed at the December meeting.

Comments by the Chairman

Chairman Roxe commented on today's meeting.

Executive Session

A motion was made by Mr. Himmelreich, seconded by Mr. Roth, that the IAC adjourn the Regular Session at 11:56 a.m. and enter into Executive Session to consider pending litigation and an employment matter. The motion was passed unanimously. Denise L. Nappier, Treasurer; Howard G. Rifkin, Deputy Treasurer; and M. Timothy Corbett, CIO, participated in the Executive Session. Catherine LaMarr, General Counsel, participated in the pending litigation portion of the executive session.

A motion was made by Mr. Murray, seconded by Mr. Himmelreich, that the Investment Advisory Council adjourn the Executive Session at 12:20 p.m. and enter into Regular Session. The motion was passed unanimously.

Chairman Roxe noted that no votes were taken during the Executive Session.

Consideration of the Salary Range and Deputy Chief Investment Officer Appointment

Treasurer Denise Nappier presented her recommendation regarding the salary range of \$175,000 to \$260,000 for the Deputy CIO of the CRPTF, and she asked that the IAC consider approving her recommendation.

Chairman Roxe asked for a motion to approve the recommended salary range for the Deputy CIO position. Peter Thor entered a motion to approve the recommended salary range. Ms. Palmer seconded the motion. Chairman Roxe then asked if there was any discussion. The motion was passed unanimously.

Treasurer Nappier presented her recommendation regarding the appointment of Lee Ann Palladino as Deputy CIO, and she asked that the IAC consider approving her recommendation.

Chairman Roxe asked for a motion to approve the recommendation of the appointment of Lee Ann Palladino as Deputy CIO for the Connecticut Retirement Plans and Trust Funds. Mr. Freeman entered a motion to approve the recommendation. Ms. Thomas seconded the motion. The motion was passed unanimously.

There being no further business, the meeting was adjourned at 12:30 p.m.

An audio tape of this meeting was recorded.

Respectfully submitted,


**DENISE L. NAPPIER
SECRETARY**

Reviewed by



**JOSEPH D. ROXE
CHAIRMAN**