INVESTMENT ADVISORY COUNCIL
Wednesday, November 14, 2012

MEETING NO. 399

Members present:	Neil G. Budnick, Chairman Janice (Jan) Carpenter Thomas Fiore, representing Benjamin Barnes Michael Freeman Laurence N. Hale David (Duke) Himmelreich William Murray Denise L. Nappier, Treasurer Carol Thomas Peter Thor
Absent:	Thomas Barnes Joshua Hall
Others present:	Christine Shaw, Deputy Treasurer Lee Ann Palladino, Chief Investment Officer Gary Carter, Interim Deputy Chief Investment Officer Gregory Franklin, Assistant Treasurer Lawrence Wilson, Assistant Treasurer Catherine LaMarr, General Counsel Terrence Purcell, Interim Principal Investment Officer Cherie Santos-Wuest, Principal Investment Officer Michael Terry, Principal Investment Officer Linda Tudan, Executive Assistant Winifred (Winnie) Scalora, Executive Secretary
Guests:	Melissa Albanesi, State Street Global Advisors Scott Booth, The Townsend Group Mary Dunleavy, State Street Bank & Trust Alan Fields, PineBridge Investments Sean Gill, NEPC Will Greene, Loop Capital Markets Alex Kamunya, NEPC John Kim, Court Square Capital Management, L.P. Robert Kochis, The Townsend Group Louis Laccavole, SOC Teachers' Retirement Board Claire Shaughnessy, Hewitt EnnisKnupp, Inc. Johnson Shum, State Street Bank & Trust Diane Smola, Hewitt EnnisKnupp, Inc. Robert Steyer, Pensions & Investments David Thomas, Court Square Capital Management, L.P. Kevin Vandolder, Hewitt EnnisKnupp, Inc.

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

<u>Approval of Minutes of the September 12, 2012 IAC Meeting</u>

Chairman Budnick asked for comments on the minutes of the September 12, 2012 IAC meeting. **There being no comments, a motion was made by Janice Carpenter, seconded by Carol Thomas, that the minutes of the September 12, 2012 IAC meeting be accepted as drafted. The motion was passed unanimously.**

<u>Comments by the Treasurer</u>

Treasurer Denise L. Nappier commented on the devastation caused by Storm Sandy to the residents of several states. She noted that even though the markets in New York were closed for two days, the Office of the Treasurer's ("OTT") business was not interrupted due to its continuity of operations plan with dedicated Treasury staff working remotely. Treasurer Nappier said that the OTT had previously scheduled a $400 million bond sale to take place the same day that the financial markets shut down. She also noted that the credit rating agencies reaffirmed the State of Connecticut's stable outlook in time for the bond sale, which was initiated immediately following Storm Sandy. Treasurer Nappier stated that the Cash Management Division's staff had also reinvested securities that were maturing, which minimized the impact on interest income when the market closed for two days. She commented that despite the hardships from the storm, many of the same people who lost so much were still intent on voting and stood in line for hours.

Next, Treasurer Nappier introduced Michael Terry, the newly hired Principal Investment Officer ("PIO") with the Treasury's Cash Management Division. She commented on his 17 years of professional experience and educational background. Mr. Terry thanked Treasurer Nappier and said that he looked forward to working with the OTT staff.

Treasurer Nappier announced her decision to make three investment commitments after considering the feedback from the IAC and the OTT's extensive due diligence process conducted by investment staff and the consultants for the Real Estate Fund ("REF") and the Private Investment Fund ("PIF"), The Townsend Group and Franklin Park Associates, LLC, respectively. She said that she had decided to hire TPG Credit Strategies Fund II, L.P. ("TPG II"), Clearlake Capital III, L.P. ("Clearlake III"), and Starwood Global Opportunity Fund IX, L.P. ("Starwood IX"). Treasurer Nappier stated that she had committed $50 million to TPG II, an $800 million private equity fund, focused on distressed asset investing primarily in the aviation and European non-performing loan market segment; and announced that the TPG II contract had been executed. Additionally, she said that Clearlake III, a $600 million private equity fund with a focus on special situations, distressed and value investments in small and middle markets, was also fully executed and that she had committed $40 million to this Fund. Finally, Treasurer Nappier said that she had decided to commit up to $50 million to Starwood IX, pending successful contract negotiations. She noted that Starwood IX, a $2 billion to $3 billion commingled opportunistic real estate fund, targeted real estate assets primarily acquired through the purchase of distressed non-performing loans. Treasurer Nappier added that the CRPTF has previous commitments of $50 million each to Starwood Opportunity Fund VII and Starwood Opportunity Fund VIII.

With respect to performance, Treasurer Nappier commented that the CRPTF had earned a one-year return of 15.19% as of September 30, 2012. Treasurer Nappier remarked that the performance was led by double digit returns across most of the CRPTF's asset classes, including its exposure to all global public equities, emerging market debt and high yield bonds. She discussed the so-called "fiscal cliff" and its looming $600 billion problem due to expiring tax cuts and spending cuts, and said that the markets would remain volatile, possibly erasing some of the gains of the CRPTF to date for the Fiscal Year 2013 ("FY 2013").

Regarding the agenda, Treasurer Nappier stated that she was officially presenting her recommended modifications to the MacBride Compliance Policy within the Appendix of the Investment Policy Statement ("IPS"). In providing an overview, she said that the amendments were required due to the passage of MacBride-related legislation during the 2012 legislative session, and that previously, the law compelled the State Treasurer to divest state funds from any company doing business in Northern Ireland that had not implemented the MacBride Principles regarding freedom from religious discrimination in the workplace. Treasurer Nappier said that the law now provided discretion to the Treasurer whether to implement an investment restriction, including divestment, and provided for greater flexibility with regard to engagement with companies and decision making. Treasurer Nappier indicated that the process was now similar to that which is followed for the Sudan law, and by design the amended MacBride law was now closely aligned with the Sudan and Iran statutes regarding the Treasurer's authority to impose investment restrictions relating to investment of state funds. She said that in drafting the IPS amendment, it was determined that a broad policy on implementation of statutory investment restrictions for Sudan, Iran and MacBride was preferable to a revised policy addressing the MacBride Principles alone, and noted that the new policy in the IPS Appendix, if approved, would replace the current MacBride Compliance Policy as was outlined in Appendix C. Treasurer Nappier said that under the IPS approval process for revisions to the Appendix, publication of notice two weeks prior to the IAC meeting was not required. Finally, she said that she looked forward to the IAC's feedback on the recommended IPS amendment.

Next, Treasurer Nappier said that one of the CRPTF's current PIF managers, Court Square Capital Management, L.P. ("Court Square"), would present Court Square Capital Partners III, L.P. ("Court Square III"), a private equity corporate finance opportunity. She noted that Court Square III focused on upper middle-market buyouts and was seeking $3 billion in commitments. Treasurer Nappier stated that she was considering an investment of up to $50 million, and noted that in 2006 the CRPTF committed $100 million to Court Square Capital Partners II, which had generated a 1.3 times net multiple on invested capital and to date had earned a 9.7% net internal rate of return.

Finally, Treasurer Nappier commented that the U.S. Supreme Court heard oral argument in the OTT's case against Amgen, Inc. She noted that the OTT became involved in this class action litigation after losing nearly $20 million as a result of allegedly misleading statements from Amgen's management related to the safety of the company's flagship products. Treasurer Nappier also said that although Connecticut was named lead plaintiff in 2007, the case had been in various stages of appeal for many years and was waiting for the U.S. Supreme Court to issue its decision, which should happen sometime near the end of the first quarter of 2013.

Update on the Market, the CRPTF Final Performance for the Months Ended August 31 and September 30, 2012; the Combined Investment Funds and Connecticut Horizon Fund Review as of September 30, 2012; and Proxy Votes and MacBride Compliance as of June 30, 2012

Lee Ann Palladino, Chief Investment Officer, provided an update on the capital market environment, its impact on the performance of the CRPTF and the economic outlook. She began by commenting on the implementation of the new asset allocations that were adopted and approved in August 2012, and said that both ranges and policy targets had been changed and were reflected in the reports as of September 30, 2012. Next, she discussed the allocation changes that were made to the benchmarks for the Emerging Market Debt Fund, the Inflation Linked Bond Fund, the High Yield Bond Fund, the Emerging Market International Stock Fund and the Developed Market International Stock Fund ("DMISF"). In response to Chairman Budnick, Ms. Palladino stated that these changes were implemented as part of the recently completed Asset and Liability Study.

With respect to the economic outlook, Ms. Palladino stated that the CRPTF's standing had improved in comparison to where it was four years ago, when the great recession was unfolding and the developed world was deleveraging. She also noted that the CRPTF's earnings as of September 30, 2012 increased 15.19% and 8.17% for the one and three-year time periods, respectively, but added that there was still uncertainty in the economic environment.

Ms. Palladino provided an executive summary on the performance of the CRPTF, which was currently valued at $24.8 billion, with increases in market value of $3.4 billion, $5.6 billion and $14.8 billion over the past one, three and five-year time horizons, respectively. She noted that over the past year, the CRPTF had paid out 4.5% of market value toward net benefit payments.

Ms. Palladino commented on the Trusts and noted that the asset allocation changes were complete on all but the Policemen and Firemen Survivors' Benefit Fund and the State's Attorneys' Retirement Fund, and upon completion of their asset allocation and liability study, the Treasurer would present IPS amendments to the asset allocations for the Trusts and the amended IPS to the IAC for review and consideration.

Ms. Palladino then introduced Claire Shaugnessy and Kevin Vanholder, Partners, and Diane Smola, Senior Consultant, of Hewitt EnnisKnupp. Mr. Vandolder provided highlights on the capital markets. He reported that the U.S. stock market earned about 30% over the last 12 months and the non-U.S. market earned roughly half of that total return.

In her report on the CRPTF, Ms. Shaugnessy stated that the overall returns were strong at 4.5% and 4.6% for the Teachers' Retirement Fund and State Employees' Retirement Fund, respectively, for the first quarter of FY 2013; and she noted that the Municipal Employees' Retirement Fund return was slightly lower due to its higher allocation to fixed income.

In response to Ms. Carpenter, Ms. Shaughnessy said that the DMISF returns were lower than the benchmark because the CRPTF portfolio was hedged at 50% in order to decrease the volatility whereas the universe was predominately un-hedged.

Next, Ms. Smola reported on the Connecticut Horizon Fund ("CHF") as of June 30, 2012. She stated that the CHF lagged its benchmark by five bps for the quarter and slightly underperformed the benchmark fiscal year-to-date, one-year, and three-year time horizons, but it outperformed by 50 bps over the five-year period.

Finally, Ms. Palladino reported on the proxy votes and MacBride Compliance for the quarter ended June 30, 2012. She said that 25% of the CRPTF's votes were against management on the domestic election of directors and it voted 13.8% against management internationally. Ms. Palladino reported no violations. In closing, she stated that this report will be presented on an annual basis going forward, should the Treasurer ultimately adopt and the IAC approve the proposed IPS amendment.

Consideration of the Investment Policy Statement Appendix Modifications

Ms. Palladino presented the Treasurer's recommended amendment to the IPS Appendix for review by the IAC. She said that the proposed amendment to the IPS reflected legislative changes to Connecticut's MacBride policy regarding freedom from religious discrimination in the workplace. Ms. Palladino added that with the passage of Public Act 12-203, the Treasurer now has discretion to implement investment restrictions – up to and including divestment – and provided greater flexibility for engagement with companies; she added that MacBride compliance was now consistent with two other statutes involving investments in Iran and Sudan. In response to Ms. Thomas, Ms. Palladino said that there were five companies in Northern Ireland that were on the list for violations and the numbers of companies continued to lessen. In response to Peter Thor, Treasurer Nappier said that the legislature supported the revised statute.

Presentation by and Consideration of Court Square Capital Partners III, L.P.

Terrence Purcell, Interim Principal Investment Officer ("PIO"), provided opening remarks and introduced Court Square III, a private investment opportunity. He said that Court Square was formed to invest in middle and upper-middle market buyout transactions. Mr. Purcell noted that Court Square III expected to raise approximately $3 billion with a $3.5 billion hard cap and that its first closing was held in January 2012. He spoke about the CRPTF's existing relationship with Court Square's management, and he commented on the PIF's earnings through its investment in Court Square II. Mr. Purcell commented on Court Square's experienced, cohesive and institutional investment team, and noted that its investment strategy targeted the U.S. middle market. In closing, he said that the General Partner's investment approach was tightly focused on four main sectors: business services; the general industrial sector; healthcare; and technology and telecommunications.

In response to Ms. Carpenter, Mr. Purcell said there were no concerns about a lack of succession plan and that Court Square had deep bench strength both at the top and middle management levels.

In response to William Murray, Mr. Purcell said that there had been no change in senior management and no change was expected over the next five years. Mr. Thor posed a question about Court Square's earnings during the economic downturn to which Mr. Purcell said that while it had lost on individual investments, its overall performance outweighed those losses.

Presentation by Court Square Capital Management, L.P.

Court Square, represented by John Kim, and David Thomas, Partners, made a presentation to the IAC. Mr. Kim began by providing a brief overview of Court Square, its experienced private equity investment teams, strong investment culture, alignment of interest, and performance track record. Next, Mr. Thomas spoke about Court Square's history beginning with its prior funds, Citigroup Venture Capital, followed by Court Square Capital Partners Funds I and II. Next, he commented on Court Square's advantages including its domain expertise, broad network, experience and reputation, and preferential/exclusive access to deal sourcing.

Mr. Kim then commented on Court Square's commitment to diversity and said that it was committed to socially responsible behavior and held itself to the highest environmental, social and governance standards in all aspects of business. He spoke about Court Square's corporate citizenship activities.

Ms. Thomas remarked on Court Square's representation of professional women within its workforce. Regarding Mr. Himmelreich's questions on Court Square's exit strategies, Mr. Thomas said that the vast majority of its sales went to strategic buyers. In response to Chairman Budnick, Mr. Thomas commented on the two partners that recently left Court Square.

Roll Call of Reactions to Court Square Capital Partners III, L.P.

Chairman Budnick requested the IAC members to provide input on Court Square III. Michael Freeman, Ms. Carpenter, Messrs. Murray and Himmelreich, Thomas Fiore, Mr. Thor, Laurence Hale, Ms. Thomas and Chairman Budnick all supported the investment.

Chairman Budnick asked for a motion to waive the 45-day comment period for Court Square III. **A motion was made by Ms. Thomas, seconded by Mr. Freeman, to waive the 45-day comment period for Court Square Capital Partners III, L.P. The motion was passed unanimously.**

Private Investment Fund Review as of June 30, 2012

Mr. Purcell reported on the PIF for the quarter ended June 30, 2012. He first noted that the PIF's targeted rate of return was the ten-year average annualized rate of return for the S&P 500 index plus a 500 basis-point premium. Mr. Purcell said that for the rolling twelve months ended June 30, 2012, the PIF gained 5.9%. He noted that the PIF's three-year return of 14.8%, while high on an absolute basis, lagged the S&P 500 PME index's 21.6% gain due to the S&P's substantial gains in 2009 that followed the steep declines of 2008. Next, Mr. Purcell commented on the longer term and said that the PIF's five-year, ten-year and inception-to-date returns were 6.7%, 7.9% and 8.4%, respectively, all surpassing the targeted return. He remarked that the majority of individual vintage year funds starting in 2002 continued to generate returns above the median and often near the top quartile benchmark.

In response to Ms. Thomas' question on cash flow, Mr. Purcell said that cash flow was expected to be fairly neutral during the 2013 calendar year.

Real Estate Fund Review as of June 30, 2012

Cherie Santos-Wuest provided an executive summary on the REF for the quarter ended June 30, 2012. Ms. Santos-Wuest commented that REF was building its way back from the depths of the recession in 2009 and had since rebounded with net returns of 6.4%, 4.0% and negative 6.6% for the one, three and five-year periods, respectively. She said that going forward, the REF was expected to provide positive longer-term returns and current income, and noted that the REF's cash-on-cash yield on an annualized basis had risen to 8.9% per year as of June 30, 2012. Ms. Santos-Wuest also reported that the CRPTF's recent real estate investments provided diversification, current income and appreciation to meet the ongoing needs for the return of the broader CRPTF.

Ms. Santos-Wuest then highlighted the REF's cash flow and noted that $33 million was called with $33.9 million returned, which reflected minimal net cash flow and was indicative of the activity within the portfolios of many of the REF's funds.

Robert Kochis, Principal of The Townsend Group, the CRPTF's consultant for the REF, provided additional commentary on the domestic and foreign, debt and equity markets. He said that the CRPTF's investments in core real estate provided exposure to the continuing recovery in real estate values and that the unfunded commitments to managers that targeted the distressed assets and access to capital within the markets also provided opportunity within the market over the short term.

Securities Lending Review as of September 30, 2012

Johnson Shum, Vice President of State Street Bank & Trust, provided a review of securities lending activity for the quarter ended September 30, 2012. Mr. Shum reported $4 million in total earnings for the quarter, an increase of 2.5%, and he noted that loan balances dropped from the prior period by about 10%. In terms of collateral spread, he said funding was fairly even when compared quarter over quarter with total returns of nearly 11 bps. In closing, Mr. Shum provided an overview of the State of Connecticut's collateral account.

Short-Term Investment Fund Review as of September 30, 2012

Lawrence Wilson, Assistant Treasurer, reported on the performance for cash management of the Short-Term Investment Fund ("STIF") for the quarters ended June 30 and September 30, 2012. Mr. Wilson reported that during the first quarter of FY 2013, the STIF had an average annual yield of 13 bps, which was 6 bps above similar money market mutual funds. He reported that for the twelve-month period ended June 30, 2012, the STIF returned 16 bps, more than three times the five bps returned for its benchmark, and resulted in an additional $5.3 million for investors in the

STIF.

Next, Mr. Wilson reported on the returns for the quarter ended September 30, 2012. He stated that the STIF earned 20 bps and was 13 bps above its benchmark. Mr. Wilson said that the STIF maintained a conservative investment strategy with about 63% of its assets invested in overnight securities or securities available on a same-day basis with a weighted average maturity of 34 days. Finally, he reported that the STIF's current reserve of roughly $48 million was just about 1% of its total assets.

Chairman Budnick commented on the STIF's positive results.

Other Business

Chairman Budnick presented the draft IAC Meeting Schedule for the 2013 Calendar Year; the August 8, 2013 IAC Meeting was canceled. **There being no further comments, a motion was made by Ms. Thomas, seconded by Ms. Carpenter, that the IAC Meeting Schedule for the 2013 Calendar Year be accepted. The motion was passed unanimously.**

Mr. Himmelreich stated that he received a request from the auditors to hold an audit committee meeting after the next IAC meeting. Mr. Murray thanked Ms. Palladino for speaking to the Danbury Teachers on the investment side of their retirement fund.

Chairman Budnick invited the IAC members to submit agenda items for the December 12, 2012 IAC meeting.

Comments by the Chairman

Chairman Budnick commented on the meeting.

There being no further business, the meeting was adjourned at 11:47 a.m.

This meeting was electronically recorded.

Respectfully submitted,

Denise L. Nappier

DENISE L. NAPPIER
SECRETARY

Reviewed by

Neil G. Budnick

NEIL G. BUDNICK
CHAIRMAN