INVESTMENT ADVISORY COUNCIL
Wednesday, September 11, 2013

MEETING NO. 408

Members present:

Janice (Jan) Carpenter
Thomas Fiore, representing Benjamin Barnes**
Laurence N. Hale
Joshua Hall
David (Duke) Himmelreich
Steven Muench
William Murray
Denise L. Nappier, Treasurer
Carol Thomas
Peter Thor*

Others present:

Christine Shaw, Deputy Treasurer
Lee Ann Palladino, Chief Investment Officer
Gary Carter, Interim Deputy Chief Investment Officer
Catherine LaMarr, General Counsel
Shelagh McClure, Director of Compliance
Terrence Purcell, Principal Investment Officer
Michael Terry, Principal Investment Officer
David Barrett, Director of Communications
Linda Tudan, Executive Assistant
Winifred (Winnie) Scalora, Executive Secretary

Guests:

Melissa Albonesi, State Street Global Advisors
Bradley Atkins, Franklin Park Associates
Ronald Burkle, Yucaipa Alliance Management, LLC
Steve Burns, The Townsend Group
Will Greene, Loop Capital Markets
Robin Kaplan-Cho, Connecticut Education Association
Louis Laccavole, SOC Teachers' Retirement Board
Norice Rice, Yucaipa Alliance Management, LLC
Diane Smola, Hewitt EnnisKnupp, Inc.
Michael Stark, The Townsend Group
Scott Stedman, Yucaipa Alliance Management, LLC
Ira Tochner, Yucaipa Alliance Management, LLC
Kevin Vandolder, Hewitt EnnisKnupp, Inc.
Jacob Walthour, Cliffwater LLC

*** Arrived at 9:02 a.m.**
**** Arrived at 9:05 a.m.**

Noting the presence of a quorum, Treasurer Denise L. Nappier, Secretary of the Investment Advisory Council ("IAC"), called the IAC meeting to order at 9:00 a.m

Treasurer Nappier acknowledged the resignation of Neil Budnick as chair and the absence of a presiding official. The IAC Secretary stated that the first order of business was the nomination of a chair *pro tempore* and called for nominations from the floor. **William Murray nominated Carol Thomas as chair *pro tempore*. Janice Carpenter seconded the nomination.** Treasurer Nappier noted that the motion had been made and seconded that Ms. Thomas be nominated for the position of chair *pro tempore*. Treasurer Nappier asked whether there were any further nominations. **David Himmelreich moved to close the nominations, which motion was seconded by Ms. Carpenter.** There being no debate, Treasurer Nappier called for a vote on the motion to close nominations. **The vote in favor was unanimous**. Noting no debate on the nomination Treasurer Nappier called for a vote on the election of Carol Thomas as chair *pro tempore*. **The vote in favor of Ms. Thomas' election was unanimous.** Treasurer Nappier and the members of the IAC congratulated Ms. Thomas.

In her first order of business, Chair *pro tempore* Thomas introduced the newest IAC member, Steven Muench. She commented on Mr. Muench's years of experience in the accounting business and noted that he was currently a mathematics teacher for the Avon Public School system. Mr. Muench said he was pleased to be a member of the IAC.

Approval of Minutes of the July 10, 2013 IAC Meeting

Chair *pro tempore* Thomas called for a motion to approve the minutes of the July 10, 2013 IAC meeting. **There being no comments, a motion was made by Mr. Murray, seconded by Ms. Carpenter, that the minutes of the July 10, 2013 IAC meeting be accepted as drafted. The motion was passed, with Laurence Hale and Mr. Muench abstaining because they were not in attendance at the July 10th meeting.**

Comments by the Treasurer

Treasurer Nappier welcomed Mr. Muench to the IAC.

Next, Treasurer Nappier announced that after considering the feedback from the IAC and the due diligence process, she had decided to make commitments to three Real Estate Fund ("REF") Open Ended Core Funds ("OECF"): JP Morgan Chase Strategic Property Fund; Prudential Property Investment Separate Account LP; and UBS Trumbull Property Funds; contingent upon successful contract negotiations. She commented on the three OECFs and their tactical fit within the Connecticut Retirement Plans and Trust Funds' ("CRPTF") policy ranges for core real estate investments.

Regarding the State laws that permit divestment of companies doing business in Northern Ireland per Connecticut's MacBride Law and in Iran or Sudan, Treasurer Nappier reported that she had removed five companies from prohibited investment status: B/E Aerospace and Manpower, Inc., which had demonstrated compliance with Connecticut's MacBride law; Nam Fatt Corp. and PECD Group both of which had ceased conducting business in Sudan; and Sasol Ltd., which had ceased doing business in Iran. Treasurer Nappier added that she was pleased that the problematic conduct of these companies had ended, and she was able to restore them to the universe of companies in which the CRPTF can invest.

Next, Treasurer Nappier commented on the investment performance of the CRPTF for the fiscal year ended June 30, 2013, and noted that the fiscal year-to-date return was 11.64%; with the three-year return at 10.14%. She remarked that the 2013 fiscal year-end performance for the State Employees' Retirement Fund ("SERF") and the Teachers' Retirement Fund ("TERF"), was 11.90% and 11.83%, respectively, and exceeded the respective actuarial assumed rates of return of 8% and 8.50%.

Finally, Treasurer Nappier commented on the agenda. She said that a Private Investment Fund ("PIF") opportunity, Yucaipa American Alliance Fund III, L.P. ("Yucaipa III"), would be presented for consideration. She said that this $1.6 billion private equity fund was being raised by Yucaipa Alliance Management, LLC ("Yucaipa"). The Fund focused primarily on U.S. middle market equity investments in control buyouts of logistics, distribution, grocery/food, retail and hospitality companies, and that it would invest in public equity, non-control and debt-related opportunistic endeavors. Treasurer Nappier added that she was considering an investment of up to $75 million. She noted that in 2008 the CRPTF committed $75 million to Yucaipa American Alliance Fund II, L.P ("Yucaipa II"), and as of December 31, 2012, Yucaipa II had generated a 19.9% net internal rate of return ("IRR") for the CRPTF with a 1.5 times multiple of invested capital.

Update on the Market, the CRPTF Final Performance for the Quarter Ended June 30, 2013 and Month ended July 31, 2013; the CRPTF Watch List, the Combined Investment Funds and Connecticut Horizon Fund Reviews as of June 30, 2013

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. Ms. Palladino began by commenting on economic themes that were present in fiscal year 2013 ("FY 2013") that influenced the CRPTF's investment results of 11.64%. She added that the CRPTF's developed market equities returned in excess of 20% for FY 2013 but that the emerging markets, which returned slightly above 3%, had not experienced the same robust equity returns. She reported that the CRPTF's global equity portfolio returned 18.5% on average, and she said that fixed income allocation had mixed returns of 76 basis points ("bps") for FY 2013. Ms. Palladino reported that the alternative strategies of private equity, real estate and hedge funds returned 9.6% and that the strongest returns were in the REF, which earned 10.26% for FY 2013.

Next, Ms. Palladino provided an executive summary of the performance of the CRPTF for the quarter ended June 30, 2013 and month ended July 31, 2013. She reported strong returns for the three-year time period and said that as of June 30, 2013, the CRPTF was valued at just under $26 billion. She added that it posted nearly $2.8 billion in market value increases to the portfolio during FY 2013. Regarding the TERF, she reported strong one and three-year returns and noted the improvement in longer-term returns, and indicated that the SERF's performance was similar to that of the TERF. She noted that the asset allocation - which was approved in July 2013 for the Police and Fireman's Survivors' Benefit Fund, Other Post-Employment Benefits Trust Fund and State's Attorneys' Retirement Fund - was implemented and brought to policy targets during August.

Finally, Ms. Palladino reported on the CRPTF Watch List, and stated that Hartford Investment Management Company ("HIMCO"), an Inflation Linked Bond Fund ("ILBF") manager, remained on the CRPTF Watch List because it represented more than 20% of the firm's strategy assets and exceeded the IPS' guidelines. She noted that a search for global inflation linked bond managers was underway in concert with the benchmark change, and that the portfolio would be reallocated once that search was completed.

Next, Dianne Smola and Kevin Vandolder, Partners of Hewitt EnnisKnupp, Inc. ("Hewitt"), reported on the Combined Investment Funds ("CIF") and the Connecticut Horizon Fund ("CHF") as of June 30, 2013. Mr. Vandolder first discussed the global equity markets, which he reported were volatile during the quarter ended June 30, 2013. With respect to fixed income markets, Mr. Vandolder reported that they had performed poorly during the first half of FY 2013, but he noted that the 10-year Treasury yield curve steepened during the quarter ended June 30, 2013. Next, he provided an overview of the hedge fund, private equity and U.S. commercial real estate markets.

Next, Ms. Smola provided a summary of the returns for the individual plans and trusts within the CIF, and she discussed the allocations for each of the funds.

Regarding the CHF, Ms. Smola reported that it had outperformed its benchmark by 40 bps during the quarter ended June 30, 2013. With respect to diversification of the funds, she reported that about 31% were women owned, 30% were minority-owned, 24% were emerging firms and about 15% were CT-based firms. Ms. Smola said there were some changes in the composition of the CHF during FY 2013 included the graduation of two funds, the addition of four funds and termination of four funds.

Presentation by and Consideration of Yucaipa American Alliance Fund III, L.P.

Terrence Purcell, Principal Investment Officer ("PIO"), provided opening remarks and introduced Yucaipa III, a PIF opportunity being raised by Yucaipa. Bradley Atkins, Chief Executive Officer of Franklin Park Associates LLC, the CRPTF's consultant for the PIF, was also present. Mr. Purcell stated that Treasurer Nappier was considering an investment of up to $75 million in Yucaipa III, a private equity fund that focused primarily on U.S. middle market equity investments in control buyouts of logistics, distribution, grocery/food, retail and hospitality companies. He discussed the CRPTF's prior commitment to Yucaipa II, and noted that it had generated a 19.3% net IRR and distributed about $40 million back to the CRPTF as of March 31, 2013.

Mr. Purcell, next mentioned Yucaipa III's core investment strategy and its long successful track record. Ms. Carpenter posed a question regarding Yucaipa III's fee structure, to which Mr. Purcell stated that the Fund charged a 1.75 % annual management fee, but would discount that by 25 bps to Limited Partners who participate in the first close or commit more than $100 million. In response to Mr. Fiore, Mr. Atkins commented on the types of investments that were made by the prior fund, Yucaipa II, which included several opportunistic and some debt investments.

Presentation by Yucaipa Alliance Management, LLC

Yucaipa III -- represented by Ronald Burkle, Managing Partner, Norice Rice, Principal; Scott Stedman and Ira Tochner, Partners - made a presentation to the IAC. Ms. Rice began by introducing the Yucaipa Management team. Next, Mr. Stedman provided a brief review of The Yucaipa Companies, founded in 1986; and commented on its investment history, discussed its notable investments and Yucaipa's experienced team.

Next, Mr. Stedman provided an executive summary as of March 31, 2013 for Yucaipa II, and he noted that $1.43 billion had been invested and $917 million had been distributed. Mr. Stedman then commented on the performance of Yucaipa II as of March 31, 2013, and noted that its investment gain was $1.38 billion. In response to Chair *pro tempore* Thomas' question about the grocery store A&P, Mr. Burkle discussed the investment obstacles A & P faced, and added that today it was on solid ground. Ms. Carpenter asked whether Yucaipa III had a geographical preference. Mr. Burkle responded that Yucaipa had several strategic relationships throughout the U.S., and to a lesser degree throughout the world. In response to Mr. Himmelreich's questions regarding the Corporate Initiatives and Special Situations Funds, Mr. Burkle discussed the history of the funds, its strategic relationship with Magic Johnson and its performance. Mr. Murray asked whether Yucaipa was still affiliated with Johnson Enterprises, to which Mr. Burkle responded that the relationship continued regarding the management of the existing investments. In response to Peter Thor's question regarding the firm's perspective on organized labor, Mr. Burkle stated that a very friendly relationship with labor existed, and he commented on its many excellent relationships with its unionized businesses. In closing, Mr. Burkle stated that Yucaipa wanted to be a good partner with the CRPTF and would like to continue its positive relationship for the long term.

Roll Call of Reactions to Yucaipa American Alliance Fund III, L.P.

Mr. Thor, Joshua Hall, Messrs. Hale and Muench, Ms. Carpenter, Messrs. Murray, Himmelreich and Fiore and Chair *pro tempore* Thomas all supported an investment in Yucaipa III.

Chair *pro tempore* Thomas called for a motion to waive the 45-day comment period. **A motion was made by Mr. Himmelreich, seconded by Mr. Murray to waive the 45-day comment period for Yucaipa III. The motion was passed unanimously.**

Alternative Investment Fund Review as of June 30, 2013

Mr. Purcell reported on the performance of the Alternative Investment Fund ("AIF") for the quarter ended June 30, 2013. He first introduced the AIF's new consultant, Jacob Walthour, Managing Director of Cliffwater, LLC ("Cliffwater"), who assisted in presenting the quarterly report. Mr. Purcell commented on Mr. Walthour and Cliffwater's extensive alternative investment experience.

Mr. Purcell reported that since inception in early 2011, roughly 84% of the AIF's committed capital had been allocated to the hedge fund-of-funds portfolio. He discussed the four Prudence Crandall ("PC") funds and noted the PC funds were managed by Permal Group, LTD, Prisma Capital Management LLC, The Rock Creek Group, LP, and K2 Advisors, L.L.C. Mr. Purcell noted that because the S&P 500 Index had gained 18.4% over the prior two year periods and had risen 34.2% over the trailing three-year period, the CRPTF utilized the advantageous period of strength in equities and fixed income to migrate some of its long-only public market exposure into hedge funds. This tactic was employed to create more exposure to investments that were not only of an absolute return nature but whose return streams were designed to carry low correlation to the returns of the public markets and to the overall returns of the CRPTF. Mr. Purcell reported that during the quarter ended June 30, 2013, $400 million was invested in newly created portfolios and provided additional comments on all of the PC funds.

Mr. Purcell reported that the Fund-of-Hedge Funds portfolio within the AIF gained 1.1% for the quarter ended June 30, 2013, once again outperforming the HFRI Fund-of-Funds Composite Index and the broad Dow Jones/Credit Suisse Hedge Fund Composite Index.

During FY 2013, Mr. Purcell reported that the Fund-of-Hedge Funds portfolio gained a strong 12.1%, outperforming the two broad hedge fund indices' gains which ranged between 8% and 9%. He indicated that the combined market value of the four PC funds rose from $539 million to approximately $945 million as a result of market value increases and the investments made during the quarter ended June 30, 2013. He also commented that the CRPTF will continue to evaluate the structuring of incremental investments through the Prudence Crandall funds on an opportunistic and timely basis to take advantage of future shifts in capital markets conditions.

With respect to the AIF's real assets portfolio, Mr. Purcell said that there had been steady ongoing investment activity within the AIF's two private market investments - ArcLight Energy Partners Fund V, L.P. and Energy Fund XV, L.P. - and he noted that since inception, the IRR of the two real asset investments remained at approximately 20% as of March 31, 2013. Regarding the opportunistic portfolio, Mr. Purcell said there was no significant investment activity during the quarter within the Marathon European Credit Opportunities Fund. In closing, Mr. Purcell said that as a result of the additional hedge fund investments and the increased market values in the real asset and opportunistic portfolios, the AIF's weighting in the CRPTF had increased from 2% to 4.5% during the last half of FY 2013.

Next, Mr. Walthour commented on the current environment for alternative investments in general and the AIF in particular. He said that the Fund-of-Hedge Funds portfolio was well diversified and that larger percentages of portfolios' investments were going to hedge funds. In closing, he said that Cliffwater was encouraging its investors to add alternatives as a risk management hedge against the potential of declining equity and bond prices.

Private Investment Fund Review as of March 31, 2013

Mr. Purcell reported on the PIF for the quarter ended March 31, 2013. He first commented on the overall returns for the PIF, and reported a gain of 9.8% versus the index's advance of 13.6% for the twelve-month period ended March 31, 2013. He added that the PIF capped this twelve-month period with a 3.1% gain for the quarter, and the PIF's 12.5% return equaled the S&P 500 index's 12.5% gain on a 3-year basis, but the PIF did not meet the targeted return of the S&P return + 500 bps. Regarding the longer term result patterns that were similar, he reported returns of 7.3%, 11.4% and 8.5%, for the 5-year, 10-year and inception-to-date periods, respectively; all surpassed the S&P 500 return. Overall, he said that the PIF continued to demonstrate positive momentum and that the vintage years since 2008 earned an aggregate net IRR of 12.9%, and remarked that the portfolio also remained well-diversified.

Mr. Purcell said that no new capital commitments closed during the quarter ended March 31, 2013 and reported that the CRPTF had closed on three investments during the twelve-month period that ended March 31, 2013.

With respect to the level of private equity industry activity during early 2013, Mr. Purcell remarked that it was mixed and that fundraising had slowed moderately with only 45 funds raising capital in the quarter versus 66 funds during 2012.

Next, Mr. Atkins provided an executive summary of the PIF's performance by vintage year. He summarized the CHF results since its inception in 2008, and he noted that the program was focused on Connecticut-based, minority, women and emerging managers, with capital allocated to 17 underlying fund managers to date. Finally, Mr. Atkins provided a market update for the PIF.

Real Estate Fund Review as of March 31, 2013

Steve Burns and Michael Stark, Associates of The Townsend Group, reported on the REF for the quarter ended March 31, 2013. Mr. Burns began by commenting on domestic real estate market conditions, and added that there was currently a pursuit for high quality such as the REF's core funds.

Mr. Stark reported that the REF was well positioned coming out of the global financial crises and that it had outperformed its National Council of Real Estate Investment Fiduciaries ("NCREIF") benchmark on a one and three-year gross return basis, and outperformed the benchmark by 7%. Regarding the Public-Private Investment Program funds, he reported that they had done very well with earnings of 16% net IRR with $230 million returned to date. He commented on additional investments that the REF had made during the 2012 and 2013 calendar years, and noted that the CRPTF was timely in these investments, and maintained its vintage year investment strategy. With respect to the REF's core funds, Mr. Stark reported that the funds would be invested over the next 12 to 18 months and would help the portfolio to achieve the strategic plan to reach the 7% target allocation. Regarding the separate account, he said that the portfolio would be a higher income producing portfolio.

Short-Term Investment Fund Review as of June 30, 2013

Michael Terry, PIO, provided a review of the Short-Term Investment Fund ("STIF"). He began by commenting on the current operating environment. He reported that the STIF earned an annualized yield of 12 bps, outperformed its benchmark by 9 bps and earned an additional $1.4 million for its investors during the quarter ended June 30, 2013. Mr. Terry said that the STIF's liquidity, which was available on an overnight and same-day basis, stood at 57%, and that the portion of the STIF that is issued, insured or guaranteed by the U.S. government stood at 52%, down 20% from a year ago. He stated that during FY 2013, the STIF increased its exposure to bank deposit instruments and bank overnight commercial paper and, in closing, Mr. Terry said that the STIF was currently attempting to diversify its banking portfolio in both regional and national banks. Treasurer Nappier remarked that the STIF continued to be a first quartile investor in the U.S. Mr. Terry added that the STIF reduced its durational or credit risk and was able to outperform most funds in its peer group.

Other Business

Ms. Palladino provided a review of the IAC budget for the fiscal year ended June 30, 2013.

Chair *pro tempore* Thomas invited the IAC members to submit agenda items for the October 9, 2013 IAC meeting.

Chair *pro tempore* Thomas read the following resolution for Neil G. Budnick:

WHEREAS, *the protection and growth of the assets of the Connecticut Retirement Plans and Trust Funds (CRPTF) is essential to the future financial security of retirees of our state, as well as to the economic strength of the State of Connecticut; and*

WHEREAS, *the Investment Advisory Council is instrumental in the stewardship of the $26 billion retirement plans and trust funds; and*

WHEREAS, *the Investment Advisory Council and the Office of the State Treasurer wish to recognize Neil G. Budnick for his outstanding contributions as Chairman of the Investment Advisory Council from September 1, 2012 through September 4, 2013; and*

WHEREAS, *the work of the Council has benefited from the overall thoroughness, keen business insight and resolve that Chairman Budnick exhibited; and*

WHEREAS, *during his tenure, Chairman Budnick's deep business experience in the financial services industry and investment community was of immeasurable benefit in leading the Council in the review and conveyance of valuable advice to Treasurer Denise Nappier for $695 million in new investment opportunities, enabling the Office of the State Treasurer to become more strategic in its investments, while maintaining a diversified portfolio to increase assets with prudent risk exposure; and*

WHEREAS, *his support for the implementation of the Office of the State Treasurer's revised Investment Policy Statement, resulting from the 2012 Asset Liability Study, brought forth his sage advice regarding the assessment of the asset classes in the CRPTF; and*

WHEREAS, *his backing of the addition of the State of Connecticut Other Post-Employment Benefits Trust Fund in the Investment Policy Statement assisted in satisfying the new trust fund's primary objective to accumulate assets and provide a reliable source of funds to supplement the State of Connecticut's payment of health care and other post-employment benefits for its retirees; and*

WHEREAS, *his sincerity, integrity and camaraderie will be greatly missed by his colleagues;*

NOW THEREFORE BE IT RESOLVED, *that the Investment Advisory Council and the Office of the State Treasurer, for themselves and on behalf of the people of Connecticut, express their gratitude and deep appreciation, and acknowledge the contributions of Neil G. Budnick during his service as Chairman of the Council.*

Given the 11th day of September, 2013.

The resolution was signed by Treasurer Nappier and Chair *pro tempore* Thomas.

<u>Comments by the Chair</u>

There being no further business, Chair *pro tempore* Thomas adjourned the meeting at 11:38 a.m.

This meeting was electronically recorded.

Respectfully submitted,

Denise L. Nappier

DENISE L. NAPPIER
SECRETARY

Reviewed by

Carol Thomas

CAROL THOMAS
CHAIR PRO TEMPORE