INVESTMENT ADVISORY COUNCIL
Wednesday, June 12, 2013

MEETING NO. 406

Members present:	Neil G. Budnick, Chairman Thomas Fiore, representing Benjamin Barnes Michael Freeman Laurence N. Hale Joshua Hall David (Duke) Himmelreich William Murray Denise L. Nappier, Treasurer Carol Thomas Peter Thor
Absent:	Janice (Jan) Carpenter
Others present:	Christine Shaw, Deputy Treasurer Lee Ann Palladino, Chief Investment Officer Gary Carter, Interim Deputy Chief Investment Officer Francis Byrd, Assistant Treasurer - Policy Catherine LaMarr, General Counsel Shelagh McClure, Director of Compliance Terrence Purcell, Interim Principal Investment Officer Cherie Santos-Wuest, Principal Investment Officer Michael Terry, Principal Investment Officer Reginald Tucker, Investment Officer David Barrett, Director of Communications Linda Tudan, Executive Assistant Winifred (Winnie) Scalora, Executive Secretary Katrina Farquhar, Administrative Assistant
Interns:	Claybourne (Alex) Couts Tyler Dew Chelsea Haddad George Miles Jeremiah Rankin Corey SeaQuist
Guests:	Melissa Albanesi, State Street Global Advisors Bradley Atkins, Franklin Park Associates, LLC Hailey Ghalib, USAA Real Estate Company Will Greene, Loop Capital Markets Margaret Hearing, Office of the State Comptroller

Robin Kaplan-Cho, Connecticut Education Association
Rob Kochis, The Townsend Group
Louis Laccavole, SOC Teachers' Retirement Board
Peter McLaughlin, USAA Real Estate Company
Claire Shaughnessy, Hewitt EnnisKnupp, Inc.
Liz Smith, AllianceBernstein Institutional Investments
Nick Stanojev, BNY Mellon Asset Management
Ryan Stanojev, Guest
Michael Stark, The Townsend Group
Scott Stuckman, USAA Real Estate Company
Kevin Vandolder, Hewitt EnnisKnupp, Inc.

With a quorum present, Chairman Neil G. Budnick called the Investment Advisory Council ("IAC") meeting to order at 9:02 a.m. Chairman Budnick announced that today was Michael Freeman's last IAC meeting, and he thanked Mr. Freeman for his service on behalf of the IAC.

Approval of Minutes of the May 8, 2013 IAC Meeting

Chairman Budnick called for a motion to approve the minutes of the May 8, 2013 IAC meeting. **There being no comments, a motion was made by William Murray, seconded by Carol Thomas, that the minutes of the May 8, 2013 IAC meeting be accepted as drafted. The motion was passed unanimously.**

Comments by the Treasurer

Treasurer Denise L. Nappier began by stating that the State budget for the ensuing biennium ending in June 2015 had passed, and she noted that this budget would fully fund the actuarially required annual contributions for the Teachers' Retirement Fund ("TERF") and the State Employees' Retirement Fund ("SERF"). Treasurer Nappier said that the budget authorized the issuance of bonds to fund a portion of the State's Generally Accepted Accounting Principles ("GAAP") deficit of an estimated $1.2 billion. She noted that the GAAP Deficit Bond Bill was an initiative conceived in the Office of the Treasurer ("OTT") and developed in partnership with the Governor's Office of Policy and Management, with an objective to address the State's long-term General Fund GAAP deficit by issuing bonds to reduce roughly half of the deficit, with the remainder amortized over a 13-year period that would begin in 2016. Treasurer Nappier stated that as with the Teachers' pension obligation bonds, a bond covenant would obligate the State to annually appropriate an amount necessary to fund the remaining GAAP deficit. She said that the issuance of the GAAP bonds would significantly improve the cash position of the General Fund, and would put the State on a much stronger financial footing to meet its obligations going forward.

Treasurer Nappier then remarked that the Connecticut Retirement Plans and Trust Funds ("CRPTF") would post a very strong fiscal-year-end performance for Fiscal Year ("FY") 2013.

Next, Treasurer Nappier introduced the OTT's six summer interns and commented on their diverse backgrounds, interests, and courses of study. She then asked everyone to welcome the 2013 interns, and requested each of them to address the IAC.

Next, Treasurer Nappier announced her decision to commit up to $75 million to Levine Leichtman Capital Partners V, L.P. ("Levine Leichtman V"), a Private Investment Fund ("PIF") opportunity, subject to successful contract negotiations. She added that Levine Leichtman V, a $1.6 billion fund, focused on middle-market debt and equity securities. Treasurer Nappier noted that she rendered this decision after considering the feedback of the IAC and the due diligence conducted by investment staff and the PIF consultant, Franklin Park Associates, LLC ("Franklin Park").

Regarding the agenda, Treasurer Nappier stated that she was presenting her recommended modifications to the Investment Policy Statement ("IPS") Appendix for consideration and review. She remarked that two pension plans and one trust fund - Policemen and Firemen Survivors' Benefit Fund ("POFI"), the State Attorneys' Retirement Fund ("SARF"), and the Other Post-Employment Benefits ("OPEB") Trust Fund - each completed its asset allocations and liability study ("A/L Study"). Treasurer Nappier said that the revisions reflecting the new asset allocations would be incorporated into the IPS. She thanked the IAC members that participated in the A/L Study Working Group for their insightful comments and feedback: Chairman Budnick, Ms. Thomas, Thomas Fiore, David Himmelreich and Mr. Murray.

Treasurer Nappier then noted that USAA Eagle Real Estate Fund ("Eagle"), a Real Estate Fund ("REF") opportunity was being presented for consideration. She added that Eagle was a core-plus, open-ended real estate strategy managed by USAA Real Estate Company ("Realco") that focused primarily on commercial properties located in the major metropolitan areas of the U.S. Treasurer Nappier said that she was considering an investment of up to $100 million. Finally, she said that the consideration of Eagle was part of a larger strategy for investment in open-end core real estate funds within the parameters of the IPS guidelines, and noted that she would present additional core real estate funds at upcoming IAC meetings.

Lastly, Treasurer Nappier said that the ability to increase or decrease allocations among core real estate managers, within IPS guidelines, would enable the OTT to effectively manage with flexibility, the open-end fund queues, manage liquidity, remain fully invested, and to tactically position the REF's core real estate within the 40% to 60% range as outlined in the IPS.

In closing, Treasurer Nappier commended Michael Freeman for his outstanding service during the past eight and a half years on behalf of Connecticut's citizens, taxpayers and pension fund beneficiaries. She added that Mr. Freeman was leaving the health of the pension fund and the IAC in good stead with the CRPTF's current performance in double-digit positive territory, far exceeding the actuarial return assumption. Finally, Treasurer Nappier said that she, along with the entire OTT and the members of the IAC, wished Mr. Freeman all the best. Chairman Budnick then read the following resolution on behalf of the IAC and the Office of the Treasurer:

WHEREAS, *the protection and growth of the assets of the Connecticut Retirement Plans and Trust Funds (CRPTF) are essential to the future financial security of government workers and 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 investment of the assets of the CRPTF; and*

WHEREAS, *the Investment Advisory Council and the Office of the State Treasurer wish to recognize Michael Freeman for his outstanding contributions as a representative of the Connecticut Education Association on the Investment Advisory Council from September 2004 through June 2013; and*

WHEREAS, *during his tenure, Mr. Freeman helped the CRPTF to navigate through unprecedented economic downturns, and provided meaningful feedback and advice on nearly $5 billion worth of private equity and real estate commitments; and*

WHEREAS, *through his diligent efforts on Council committees, including Personnel and Education, Mr. Freeman was instrumental in assisting the Office of the State Treasurer in the hiring of two Chief Investment Officers and two Deputy Chief Investment Officers for the Pension Fund Management Division; and*

WHEREAS, *Mr. Freeman's commitment to serve the people of Connecticut was demonstrated in his longstanding support for fully funding the State's pension obligations, and in his leadership in publicly endorsing efforts to reduce the unfunded liability of the Teachers' Retirement Fund, which resulted in the sale of $2 billion in Pension Obligation Bonds that strengthened the financial health of the Teachers' Retirement Fund; and*

WHEREAS, *the work of the Council has benefited from the overall attentiveness, keen insight, resourcefulness and resolve he exhibited in meeting the obligations of Council membership; and*

WHEREAS, *Michael's 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 Treasurer, for themselves and on behalf of the people of Connecticut, express their gratitude and deep appreciation, and acknowledge the substantial contributions of Michael Freeman during his service as a member of the Council.*

A motion was made by Joshua Hall, seconded by Ms. Thomas, to adopt the resolution that the Investment Advisory Council and the Office of the Treasurer, for themselves and on behalf of the people of Connecticut, express gratitude and appreciation and acknowledge the substantial contributions of Michael Freeman during his service as a member of the Council. The motion was passed unanimously.

The resolution was signed by Treasurer Nappier and Chairman Budnick. Mr. Freeman thanked everyone.

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

Lee Ann Palladino, Chief Investment Officer ("CIO"), provided an update on the capital market environment, its impact on the performance of the CRPTF and the economic outlook. Ms. Palladino first commented that all eyes were currently on the Federal Open Market Committee and the outlook for future monetary policy in the U.S. She remarked that as FY 2014 approached, she expected the tapering of monetary policy would begin, which would likely impact the valuation of assets, particularly if interest rates rose.

Regarding FY 2013, Ms. Palladino stated that the positive economic news and monetary policy helped to increase returns across the board, especially in the equity and credit-related asset classes. Ms. Palladino reported that through April 30, 2013, the CRPTF earned 14.09% for the fiscal year to date, and noted that the performance was driven primarily by equity returns. Finally, she reported that the CRPTF was expected to return 14.1% through May 2013 and that the portfolio was still up by 13.2% as of June 10, 2013. She concurred with Treasurer Nappier's statement that FY 2013 would end with a solid performance.

Next, Claire Shaughnessy and Kevin Vandolder, Partners of Hewitt, reported on the Combined Investment Funds ("CIF") and the Connecticut Horizon Fund ("CHF") as of March 31, 2013. Mr. Vandolder first highlighted the capital markets. Ms. Thomas posed questions regarding the performance of the Inflation Linked Bond Fund ("ILBF"), to which Ms. Shaughnessy said that the ILBF's benchmark had changed in September 2012. In response to Mr. Murray's question regarding cash return, Mr. Vandolder said that he expected cash performance to return to more historical levels in the next 36 months, and added that the market was moving in a more typical pattern.

In response to Chairman Budnick, Ms. Shaughnessy said that private equity was expected to earn a premium over public equities over the long term. Finally, she commented on the asset allocations and attributions for the SERF, TERF and the Municipal Employees' Retirement Fund ("MERF").

Ms. Shaughnessy also reported on the Connecticut Horizon Fund ("CHF"), and said it earned 8.3% as of March 31, 2013, which matched the benchmark. She reported that since inception, the CHF earned 5.8%; 10 basis points ("bps") greater than the benchmark net of all fees. Regarding diversification of the funds, she reported that roughly 33% of the underlying managers are women-owned, 22% were emerging managers, 11% of the firms were CT-based, and that remaining allocation included African-American, Asian-American, Native-American and Hispanic firm.

Next, Ms. Palladino reported on the CRPTF Watch List, and stated that only one manager was currently on the CRPTF Watch List - Hartford Investment Management Company ("HIMCO"), an ILBF manager. She noted that HIMCO was placed on watch in June 2012 because the CRPTF assets in the strategy represented more than 20% of the firm's strategy assets, thereby exceeding the IPS' guidelines. Ms. Palladino noted that a search for global inflation linked bond managers was underway in concert with the benchmark change, and that once that search was completed, the portfolio would be remodeled and reconstructed. Ms. Palladino said at that point, HIMCO would be reevaluated to determine how it fit in the portfolio from a strategic perspective.

Next, Ms. Palladino presented an executive summary of the Asset Liability Study ("A/L Study") that had just been completed for the Policemen and Firemen Survivors' Benefit Fund ("POFI"), State Attorneys' Retirement Fund ("SARF") and Other Post-Employment Benefits Trust Fund ("OPEB Trust Fund"). Broadly speaking, Ms. Palladino said that the goal of an A/L Study was to understand the pension plan assets as well as the liabilities in terms of risk and return and to identify the optimal pension investment strategies given the unique needs of each pension plan or trust fund. Ms. Palladino then provided important points about the unique needs and cash requirements for the three funds.

She then presented the proposed asset allocation results for the POFI, SARF and OPEB Trust Fund. Ms. Palladino reminded the IAC that setting the ranges around the upper and lower boundaries of the policy target was important for managing the risk of a diversified investment program, and she noted the importance of maintaining these asset allocations within those ranges to ensure that the plans generated the targeted risk and return over the long term, while allowing for flexibility to tactically position the portfolio and manage the costs of rebalancing. Ms. Palladino then reviewed the proposed asset allocation for each plan and trust and discussed the strategy for each. Mr. Himmelreich asked if these studies were archived, to which Ms. Palladino answered that they would be. In closing, Ms. Palladino commented that September 2013 would mark the one-year anniversary of the commencement of the implementation of the A/L Study and most of the program had been executed.

Presentation and Consideration for Approval of the Treasurer's Proposed Amendments to the Investment Policy Statement Appendix

Ms. Palladino presented the Treasurer's draft amendments to Appendix A, Sections I and II of the IPS. She said that the IPS Appendix amendments were products of the 2012 A/L Study, and also included some minor edits and reiterated her prior comments that the asset allocations for the two pension plans and one trust fund were revised to reflect the outlook for returns in the capital markets, the liquidity needs, an assessment of liabilities and other financial conditions. Ms. Palladino said that Treasurer Nappier looked forward to feedback from the IAC on her proposed amendments.

There were no formal comments presented by the IAC for the Treasurer's consideration.

<u>Presentation by and Consideration of USAA Eagle Real Estate Fund</u>

Cherie Santos-Wuest, Principal Investment Officer ("PIO"), provided opening remarks and introduced Eagle, a real estate investment opportunity. Robert Kochis, Principal, and Michael Stark, Associate of The Townsend Group, the CRPTF's consultant for the REF, were also present. Ms. Santos-Wuest stated that Treasurer Nappier was considering an investment of up to $100 million in Eagle, a newly launched core plus real estate fund managed by Realco, which would add to and enhance the REF's core strategy with slightly higher returns than traditional core funds through moderately higher leverage levels and a higher value-add component. She commented on Eagle's investments throughout the U.S. that had consistently outperformed the benchmark, and she said that Eagle would specifically focus on the growth markets particularly in health care, technology, energy and markets with adequate size and transaction volume, and discussed how Eagle would complement the REF portfolio.

Presentation by USAA Real Estate Company

Realco -- represented by Peter McLaughlin, Associate Portfolio Manager; Hailey Ghalib, Managing Director; and Scott Stuckman, Managing Director -- made a presentation to the IAC. Mr. Stuckman introduced the team, provided an overview of Realco's parent company, USAA, and highlighted Realco's strategy. He noted that Realco had outperformed the National Council of Real Estate Investment Fiduciaries Property Index ("NCREIF") eleven out of twelve years and outperformed the NCREIF by about 325 bps over the last ten years in aggregate. Ms. Thomas asked if Realco had a target demographic for its multi-family properties. Ms. Ghalib responded that Realco's focus was in urban and centrally located Class A multi-family within primary markets throughout the U.S. Chairman Budnick asked about target leverage requirements combined with pricing and how Realco could compete, to which Mr. Stuckman said that Realco was primarily an investor that pursued the long-term real estate fundamentals to determine the ability to maintain value through various economic environments. He added that Realco's strategy included long-term leases, green building and modern technology, which tended to attract tenants over longer periods of time.

In response to Ms. Thomas's question regarding workforce diversity, Mr. Stuckman said that Realco was a wholly-owned subsidiary of USAA, which mandated diversity and it currently was 46% minority and 56% women. He also noted that the firm's top leadership, including the current Chairman, President and CEO, are all minorities. In response to Laurence Hale's question regarding Realco's use of leverage, Ms. Ghalib said that it had a very disciplined approach to using leverage, and added that multi-family construction ordinarily required slightly higher leverage, but Realco placed caps on its construction debt.

Roll Call of Reactions for Consideration of USAA Eagle Real Estate Fund

Messrs. Freeman, Murray, Himmelreich, Hale and Hall, Fiore, Peter Thor, Ms. Thomas and Chairman Budnick all supported an investment in Eagle. Mr. Freeman added that Eagle's team was strong. Mr. Himmelreich added that he was impressed that they were able to build multi-family complexes in both San Francisco and Santa Monica, CA. Ms. Thomas added that she was interested in the idea of an open-end fund given the CRPTF's long-term horizon.

Chairman Budnick called for a motion to waive the 45-day comment period. **A motion was made by Ms. Thomas, seconded by Mr. Freeman, to waive the 45-day comment period for USAA Eagle Real Estate Fund. The motion was passed unanimously.**

Alternative Investment Fund Review as of March 31, 2013

Terrence Purcell, PIO, reported on the performance of the Alternative Investment Fund ("AIF") for the quarter ended March 31, 2013. Mr. Purcell first noted that the AIF report had been prepared by NEPC, the AIF investment consultant for the past five years. He added that the CRPTF was transitioning its consultancy services from NEPC to Cliffwater, LLC, which would assist in presenting the next AIF quarterly report to the IAC. Mr. Purcell reported that since inception in early 2011, roughly 75% of the AIF's committed capital had been allocated to the fund-of-hedge fund portfolio as of March 31, 2013. Mr. Purcell reported that the fund-of-hedge fund portfolio had earned 4.4% for the quarter ended March 31, 2013, which compared favorably with the HFRI fund-of-hedge fund Composite Index as well as the broad Dow Jones/Credit Suisse ("DJCS") Hedge Fund Composite Index. He added that the fund-of-hedge fund portfolio earned 8.7% for the rolling twelve-month period ended March 31, 2013, outperforming both the HFRI fund-of-hedge fund index return of 4.8% and the broad DJCS Hedge Fund Composite Index's 7.2%. He commented that the AIF's fund-of-hedge fund portfolio continued to be well-diversified across underlying managers and strategies. Mr. Purcell reported on the AIF's exposure to real assets and opportunistic investments as outlined in the quarterly report.

Private Investment Fund Review as of December 31, 2012

Mr. Purcell began his report on the PIF for the year ended December 31, 2012 by stating that the PIF's targeted rate of return is the ten-year average annualized rate of return for the S&P 500 index plus a 500 basis point premium. He reported that the PIF returned 10.9% for the 2012 calendar year. Mr. Purcell added that the PIF's three-year return of 12.7% outperformed the S&P 500 index's 11.2% gain. Regarding the longer-term time horizons, he said that the PIF's 5-year, 10-year and inception-to-date returns were 6.0%, 10.5% and 8.5%, respectively; all surpassed the S&P 500 benchmark return, but lagged the targeted return. Mr. Purcell reported that the majority of individual vintage year funds starting with the 2002 funds continued to generate returns above the median, and that the PIF's individual vintage returns from 2002 through 2010, the most recent vintage with meaningful performance figures, had outperformed the median returns for those years in seven out of the nine cases.

For the 2012 calendar year, Mr. Purcell reported that the CRPTF closed on five investments within the PIF for an aggregate capital commitment of $255 million. Regarding the PIF's cash flow as of December 31, 2012, Mr. Purcell reported that it was positive at $125 million with $428 million of capital contributed to partnerships and $553 million in distributions back to the CRPTF. He stated that a significant reason for the recent increased level of distributions back to the CRPTF and other limited partners was the continued prevalence of dividend recapitalizations, and that the main driver of this practice was clearly the ongoing low interest rate levels and the ability by portfolio companies to borrow at attractive spreads to risk-free rates.

Bradley Atkins, Chief Executive Officer of Franklin Park, compared the PIF's performance to its peer universe benchmarks since 2002. Mr. Atkins provided an attribution analysis in order to explain why the PIF underperformed relative to the benchmark, and he stated that the 1987 to 2002 vintage year funds had generated lackluster returns and continued to drag down overall earnings. He said that these early vintage year funds affected the combined pre-2008 vintage years' earnings of a net IRR of 8.4%, whereas the 2008 to 2012 vintage year funds returned 12.9%. He noted that the trend was good, better results were coming from the younger vintage year funds, and that the PIF was still being dragged down by the 1990's vintage year funds. In response to Ms. Thomas' question regarding closing out the earlier funds, Mr. Atkins responded that the funds were winding down and they would be liquidated over the next 5 years.

Real Estate Fund Review as of December 31, 2012

Ms. Santos-Wuest reported on the REF for the quarter ended December 31, 2012. Mr. Kochis and Mr. Stark provided additional comments. Ms. Santos-Wuest began by commenting that the REF had been rebounding across all markets and sectors since hitting its lowest point in 2009. She reported that the REF had outperformed its NCREIF benchmark on a quarterly, one and three-year gross return basis, and that on a net return basis, the one, three and five-year returns were 12.3%, 11.4% and negative 5.6%, respectively; the returns reflected the strong recovery of the real estate market. She added that even in the current slow-growth environment, the historically low current interest rates had lifted real estate and fueled new investments in the sector. Ms. Santos-Wuest said that she expected the demand for real estate to continue to rise due to its relative low volatility compared to the stock markets, which would bolster the value of the REF.

Next, Ms. Santos-Wuest detailed recent developments in the REF portfolio including the impending sale and purchase of assets. Next, Mr. Kochis highlighted Townsend's current view of the real estate market, In response to Chairman Budnick's question, Mr. Kochis said that real estate was interest rate sensitive and that did impact real estate values. Discussion continued regarding how increases in interest rates affected real estate and the overall economy.

Short-Term Investment Fund Review as of March 31, 2013

Michael Terry, PIO, provided a review of the Short-Term Investment Fund ("STIF") and reported that the STIF continued to outperform its benchmark by 8 bps, an increase of 12 bps during the quarter ended March 31, 2013. He stated that currently the STIF had $4.8 billion in assets and was presently not accruing reserves. Regarding the weighted average maturity for the STIF, Mr. Terry reported a marginal increase from 42 days on March 31, 2013 to 44 days currently. Finally, he reported that the STIF's reserves were currently at $49.7 million. He remarked that in order to deal with very low short-term interest rates, the STIF was increasing its exposure to bank deposit instruments by drawing down both existing deposit instruments and diversifying the portfolio with new bank deposit instruments that were backed by a federal home loan line of credit, which provided an A1+ credit rating in order to increase the yield and safety of the portfolio.

Chairman Budnick posed a question regarding the STIF's ability to have longer maturities and more flexibility in order to increase the yield, to which Mr. Terry responded that because the STIF was currently a 2-A7 like fund, the IPS and the rating agency limited the maturity and the flexibility of the STIF. Treasurer Nappier commented that there were options outside the STIF that had longer maturities and more flexibility such as STIF Plus, an intermediate fund that did not necessarily require an AAA rating. Mr. Terry added that the STIF Plus fund was a variable net asset value fund with more flexibility, but it was currently only open to the State of Connecticut, not to other investors; but added that if a more aggressive fund was needed, one could be provided.

Other Business

Chairman Budnick asked Ms. Thomas to provide a report on off-site education. Ms. Thomas spoke about the Harvard Institute for Responsible Investing, and noted that there were two speakers that discussed venture capital and hedge funds. She said that an item of discussion was regarding the fact that as investors, pension funds paid people that were supporting groups that were trying to eliminate pension funds entirely through both privatization and switching to defined contribution funds. Ms. Thomas remarked about a research institute report that viewed this issue from a purely financial point of view and said she would provide the report to the IAC. She said that the IAC would benefit from the speakers that provided relevant reports on venture capital, hedge funds and reducing fees. He then asked the IAC members to submit ideas for these presentations.

Finally, Chairman Budnick invited the IAC members to submit agenda items for the July 10, 2013 IAC meeting.

Comments by the Chairman

There being no further business, Chairman Budnick adjourned the meeting at 11:36 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