INVESTMENT ADVISORY COUNCIL
Wednesday, June 11, 2014

MEETING NO. 417

Members present:	Janice (Jan) Carpenter Thomas Fiore, representing Benjamin Barnes Joshua Hall David (Duke) Himmelreich Steven Muench William Murray Denise L. Nappier, Treasurer Carol Thomas, Interim Chair Peter Thor
Absent:	Laurence Hale
Others present:	Christine Shaw, Deputy Treasurer Lee Ann Palladino, Chief Investment Officer Deborah Spalding, Deputy Chief Investment Officer David Barrett, Director of Communications Gary L. Carter, Principal Investment Officer Joanne Dombrosky, Principal Investment Officer Laura Jordan, Interim Assistant Treasurer of Policy Harvey Kelly, Analyst Catherine E. LaMarr, General Counsel Shelagh McClure, Director of Compliance Christina McGinnis, Executive Secretary Terrence Purcell, Principal Investment Officer Cherie Santos-Wuest, Principal Investment Officer Michael Terry, Principal Investment Officer Linda Tudan, Executive Assistant
Guests:	Bradley Atkins, Franklin Park Associates Adriana Borges, Summer Worker Devin Dillard, Summer Worker Oren Faircloth, Summer Worker Joseph Felix, Summer Worker Jerald Gooden, Summer Worker Javim Gordon, Summer Worker Breana Green, Summer Worker Will Greene, Loop Capital Markets Mark Johnson, Cliffwater, LLC

Hafsa Khanum, Summer Worker
Michael Lefton, Starwood Capital Group Global, L.P.
Kevin Meehan, Goldman Sachs Asset Management
Robert Minatti, Summer Worker
Ellis Rinaldi, Starwood Capital Group Global, L.P.
Lionel Samuel, Summer Worker
Jerome Silvey, Starwood Capital Group Global, L.P.
Lynn Sliwa, Summer Worker
Claire Shaugnessy, Hewitt EnnisKnupp, Inc.
Diane Smola, Hewitt EnnisKnupp, Inc.
Adrianna Soldevila, Summer Worker

With a quorum present, Interim Chair Carol Thomas called the Investment Advisory Council ("IAC") meeting to order at 9:00 a.m.

Approval of Minutes of the May 14, 2014 IAC Meeting

Chair Thomas called for a motion to approve the minutes of the May 14, 2014 IAC meeting. **Jan Carpenter moved to approve the minutes of the May 14, 2014 IAC meeting as drafted. The motion was seconded by Steven Muench. There being no discussion, the Chair called for the vote. The motion passed with one abstention from William Murray.**

Comments by the Treasurer

Treasurer Denise L. Nappier began her opening remarks by introducing the summer workers who have joined the Office of the State Treasurer. She then commented on the adjournment of the General Assembly's regular session. Treasurer Nappier noted that due to the decrease in the projected fiscal year end surplus – attributed to diminished revenues – the proposed $100 million supplemental pension payment to the State Employees' Retirement Fund ("SERF"), which had been part of Governor Malloy's key budget initiatives for fiscal year 2014, did not materialize. Treasurer Nappier reiterated her longstanding commitment to encouraging the Governor and General Assembly to address the State's unfunded pension liabilities, and acknowledged their efforts to annually appropriate the actuarial recommended contribution to the SERF pension plan.

Treasurer Nappier then announced that after considering the feedback from the IAC, the Real Estate Fund ("REF") consultant, The Townsend Group ("Townsend"), and the due diligence process, she had decided to commit up to $100 million to Clarion Lion Industrial Trust, contingent upon successful negotiation of the partnership documents.

Next, Treasurer Nappier announced that after considering the feedback from the IAC and the due diligence process conducted by the investment professionals and the general investment consultant, Hewitt EnnisKnupp ("HEK"), she had decided to hire First Quadrant and Pareto Investment Management, pending successful contract negotiations, to supervise and direct the investments of active and passive foreign currency exposure in separately managed accounts in the Developed Markets International Stock Fund ("DMISF").

Treasurer Nappier next discussed the investment performance of the Teachers' Retirement Fund ("TERF") and the SERF for the month ended April 30, 2014. She said both funds, the two largest pension funds in the Connecticut Retirement Plans and Trust Funds ("CRPTF"), experienced solid fiscal year-to-date returns of 12.26% for the TERF and 12.14% for the SERF, which surpassed the actuarial assumed rates of return of 8.5% for TERF and 8% for SERF. She further stated that both TERF and SERF outperformed their customized benchmarks by 50 basis points ('bps") and 24 bps, respectively. Treasurer Nappier also noted that the strong fiscal year-to-date performance was led by another consecutive month of solid returns in equity markets, including the Mutual Equity Fund, which returned 19.47%, and the DMISF, which returned 18.93%. She said the investment performance results demonstrated increased stability in the global equity markets, which had helped drive the five year returns of 12.09% for TERF and 12.20% for SERF.

Finally, Treasurer Nappier stated that a real estate investment opportunity would be presented for the IAC's consideration – Starwood Distressed Opportunity Fund X ("SOF X"), a commingled opportunistic fund being raised by the General Partner ("GP"), Starwood Capital Group Global, L.P., ("Starwood"), a Connecticut-based firm with over $23 billion of assets under management. She said the REF had an aggregate of $150 million in investments in the firm's opportunity funds. Treasurer Nappier discussed the careful consideration she rendered regarding the corporate citizenship profile of Starwood and its principals. She said she had met personally with Barry Sternlicht, Starwood's Chairman and Chief Executive Officer ("CEO"), and discussed at length the company's approach to responsible contracting and fair labor practices. After having weighed the information in conjunction with the merits of the investment opportunity, she determined that SOF X was a good strategic fit for the CRPTF.

Update on the Market, the CRPTF's Final Performance for the Month Ended April 30, 2014

Lee Ann Palladino, Chief Investment Officer, began her remarks by discussing one provision of the Dodd-Frank Act that required private equity and hedge fund managers to register as investment advisers and be subject to regulatory oversight and examination by the Securities and Exchange Commission ("SEC"). She said that examination findings at some of the private equity firms highlighted the lack of transparency surrounding fee arrangements that potentially accrued to the benefit of the GP.

Ms. Palladino noted that since contracts are negotiated independently between GPs and Limited Partners ("LP"), no two contracts were exactly alike, and that she could only speak to the CRPTF's program. She noted that the CRPTF contracts typically included a clause that allowed for a transaction fee offset. She defined a transaction fee offset as the fee income received by the GP as a result of contractual arrangements with a portfolio company, which would offset the management fee by as much as 100%. She said that this office considered a 100% transaction fee offset as best practice and strived to negotiate this in each LP contract.

Ms. Palladino then outlined the highly extensive pre- and post- due diligence process utilized by this office when evaluating a GP and its investment opportunity. She outlined the layers of due diligence performed by experienced in-house investment and legal professionals, specialized consultants and outside legal counsel to negotiate and execute a contract. She said that after a contract is signed, the investment is monitored over the life of the contract. She added that new SEC regulatory oversight and examination may result in greater transparency or enhanced reporting requirements which will facilitate the existing due diligence process.

Treasurer Nappier pointed out that the monitoring process and compliance with contractual provisions would be hampered if either fraud or any event that prevents full access to contractually-required information is not disclosed.

Ms. Palladino concluded that fee transparency is an important consideration in the assessment of a potential manager. She stated that the due diligence process continues to evolve as new information or best practice standards become available.

Several of the IAC members posed questions surrounding the fees, to which Ms. Palladino and Catherine LaMarr, General Counsel, responded to the satisfaction of the IAC members.

Ms. Palladino then provided an update on the capital market environment, the economic outlook, and its impact on the performance of the CRPTF. She reported that through April 30, 2014, the TERF and SERF returned 12.26% and 12.14%, respectively, for fiscal year-to-date. She said that TERF's performance fiscal year-to-date was driven by equity returns of 16.8%, representing 55% of the portfolio; fixed income returns of 4.30%, representing 20% of the portfolio; and a 10.73% return for alternative investments, representing 20% of the TERF. Performance remained solid over the longer term horizon with the TERF and SERF returning 12.09% and 12.20%, respectively over the five year horizon.

Finally, Ms. Palladino reported on the CRPTF Watch List, and stated that Hartford Investment Management Company, an inflation-linked bond fund manager, was removed from the Watch List, and that the firm was now within the Investment Policy Statement ("IPS") guidelines. She stated that Ambassador Capital Management ("Ambassador"), a money market fund manager for the Liquidity Fund, remained on the Watch List because the Office of the Treasurer was notified that the SEC had initiated fraud allegations against Ambassador for non-compliance with the firm's own internal guidelines and for misrepresentation of the level of risk in a former money market fund. Ms. Palladino added that the manager's rating, provided by the general investment consultant, HEK, remained the same pending the outcome of the trial.

Next, Claire Shaughnessy, Partner, and Diane Smola, Senior Consultant, of HEK, reported on the Combined Investment Funds ("CIF") and the Connecticut Horizon Fund ("CHF") for the quarter ended March 31, 2014. Ms. Shaughnessy said the CIF returned 1.51% for the quarter, while one-year returns were 10.71%. Her report also included a market overview with comments on the global equity and fixed income markets. Ms. Shaughnessy compared the investment landscape during the quarter in terms of performance of various equity market capitalization portfolios, the level of interest rates, and changes in credit spreads.

Next, Ms. Smola provided a summary of the returns for the individual plans and trusts within the CRPTF, and reviewed the performance attribution for the TERF, SERF and the Municipal Employees' Retirement Fund.

Finally, Ms. Smola provided a report on the CHF for the period ended March 31, 2014. She said that the fiscal year-to-date returns were a very robust 17.3%, and outperformed its benchmark by 0.6% bps. She said that since inception the public market CHF returned 7.3%, matching its benchmark.

Ms. Carpenter questioned the separate reporting of returns for each pension and trust fund, rather than the average return of the all the pension plans and trusts that make up the CRPTF, and requested that the aggregate return information be furnished on a regular basis. Ms. Palladino responded that the rationale for reporting returns for each plan and trust was that the asset allocations for the largest pension plans differed markedly from the asset allocations of the trusts. Interim Chair Thomas added that during the most recent Asset Allocation and Liability Study ("A/L Study"), members of the IAC agreed that the fundamental differences in allocations made an aggregate measure of return for the entire CRPTF inaccurate, when compared with the returns of other similar pension plans. Treasurer Nappier noted that the IAC members, through the A/L Study process, initiated the decision to present performance information in this manner.

<u>Presentation by and Consideration of Starwood Distressed Opportunity Fund X</u>

Cherie Santos-Wuest, Principal Investment Officer ("PIO"), provided opening remarks and introduced Starwood Distressed Opportunity Fund X, L.P. ("SOF X"), an REF opportunity. Ms. Santos-Wuest stated that Treasurer Nappier was considering an investment of up to $100 million in SOF X, a $4.0-$5.0 billion opportunistic real estate fund being raised by Connecticut-based sponsor, Starwood Capital Group Global, L.P "(Starwood"). Next, Ms. Santos-Wuest gave an overview of the investment merits of the SOF X. She said the commitment to SOF X would be an opportunity to meet the CRPTF target goals and enhance the REF portfolio returns.

Presentation by Starwood Distressed Opportunity Fund X, L.P.

Starwood Distressed Opportunity Fund X, represented by Jerome Silvey, Executive Vice President and Chief Financial Officer; Ellis Rinaldi, General Counsel; and Michael Lefton, Director; made a presentation to the IAC. Mr. Silvey introduced the team and provided a brief executive summary of SOF X. He then gave an overview of the global organization, and stated that Starwood was a private investment firm headquartered in Greenwich, Connecticut, with over 380 professionals focused on the global real estate and real estate securities arenas. Mr. Silvey then discussed the different business lines and described their competitive advantages and investment themes. Mr. Silvey stated that Starwood would continue the successful investment themes of predecessor funds, SOF IX and SOF VIII, which focused on opportunistic global real estate investments.

Mr. Muench, Mr. Murray, Ms. Carpenter and Peter Thor posed questions concerning the investment themes and corporate citizenship, to which Mr. Silvey answered to their satisfaction.

Roll Call of Reactions to Starwood Distressed Opportunity Fund X

Thomas Fiore, David Himmelreich, Messrs. Murray, Muench, Thor, Ms. Carpenter, Joshua Hall, and Chair Thomas provided feedback to the Treasurer on the Starwood Distressed Opportunity Fund X. Messrs. Thor and Murray discussed concerns surrounding corporate citizenship but noted the strengths of the investment merits. Mr. Hall said he would not support a firm that makes contributions that are in conflict with teachers. With the exception of Mr. Hall, all the IAC members supported an investment in Starwood Distressed Opportunity Fund X.

Chair Thomas called for a motion to waive the 45-day comment period. **A motion was made by Ms. Carpenter, seconded by Mr. Thor, to waive the 45-day comment period for the Starwood Distressed Opportunity Fund X. There being no discussion, the Chair put the question to a vote and the motion passed with the abstention of Mr. Hall.**

<u>Alternative Investment Fund Review as of March 31, 2014</u>

Terrence Purcell, PIO, reported on the Alternative Investment Fund ("AIF") for the quarter ended March 31, 2014 (absolute return portfolio) and the quarter ended December 31, 2013 (real assets and opportunistic portfolios). His report consisted of an executive summary including a portfolio overview, benchmark performance, portfolio investment activity and fund level performance. Next, he introduced the AIF's consultant, Mark Johnson, Managing Director of Cliffwater LLC ("Cliffwater"), who assisted in presenting the quarterly report.

Mr. Purcell reported that as of March 31, 2014, roughly 87% of the AIF's committed capital was allocated to the fund-of-hedge fund portfolio. He reported that the fund-of-hedge fund portfolio had earned 1.61% for the quarter ended March 31, 2014. He continued that this result compared favorably with the HFRI fund-of-hedge fund Composite Index (0.47%), as well as the broad

HFRI Fund Weighted Composite Index (1.06%). Mr. Purcell added that the fund-of-hedge fund portfolio earned 9.76% for the one-year ended March 31, 2014, outperforming both the HFRI fund-of-hedge fund index return of 5.95% and the broad HFRI Fund Weighted Composite Index of 6.45%. He commented that the AIF's fund-of-hedge fund portfolio continued to be well-diversified across underlying managers and strategies.

Mr. Purcell next reported on the AIF's exposure to real assets and opportunistic investments as outlined in the quarterly report, and noted that the performance results were as of December 31, 2013. He stated that the real asset and opportunistic portfolios continued to perform well, and generated a 15.04% combined net internal rate of return since inception.
Next, Mark Johnson from Cliffwater commented on the fund-of-hedge fund portfolio and general hedge fund industry trends.

Private Investment Fund Review as of December 31, 2013

Mr. Purcell reported on the Private Investment Fund ("PIF") for the quarter ended December 31, 2013. He introduced the PIF's consultant, Bradley Atkins, CEO of Franklin Park Associates, who assisted in presenting the quarterly report.

Mr. Purcell's report consisted of an executive summary that included a portfolio overview, benchmark performance, and portfolio investment activity. He said the PIF portfolio returned 17.5% for the calendar year 2013, versus a 32.6% gain in the S&P 500. He further commented on the portfolio's 3-year, 5-year and 10-year returns of 11.6%, 13.8% and 9.5%, respectively, versus the S&P 500's returns of 16.1%, 18.1% and 7.8% for those timeframes.

Mr. Atkins provided an overview of the private equity landscape, fund raising levels, and initial public offering activity. He also discussed the performance of the U.S. buyout and venture capital portfolios by vintage year.

Next, Mr. Atkins provided a report on the CHF and stated that inception-to-date returns were 8.8%. Finally, Mr. Atkins noted that the CHF portfolio had been coming out of the J-curve, which he said was a good indication for the fund. He also described some of the demographics of the CHF.

Short-Term Investment Fund Review as of March 31, 2014

Michael Terry, PIO, reported on the performance of the Short Term Investment Fund ("STIF") for the quarter ended March 31, 2014. Mr. Terry said the STIF earned an annualized yield of 16 bps during the quarter, outperforming its benchmark by 14 bps. He stated that for the twelve month period ended March 31, 2014 the fund earned an annual return of 13 bps, outperforming its benchmark by 11 bps. He noted that currently, the STIF had \$4.2 billion in assets and \$50.3 million in reserves. Finally, Mr. Terry reported that the fund's weighted average maturity was 38 days at the end of the period; daily liquidity was 56% of assets; and 54% of STIF's assets were invested in securities issued, insured or guaranteed by the U.S. government or federal agencies, in repurchase agreements backed by such securities, or in money funds comprised of such securities. He also provided an economic overview, including current information on the economic growth rate, inflation rate and the short-term yield curve.

Report on the CRPTF Compliance Policy for Implementation of Statutory Investment Restrictions

Shelagh McClure, Director of Compliance, provided information on the CRPTF Compliance Policy for Implementation of Statutory Investment Restrictions. She reported on the status of the Sudan, Iran and MacBride initiatives, and stated that in regard to the Sudan law, there were no additional companies added to the CRPTF's prohibited list during the past fiscal year. Ms. McClure said that on April 2, 2013, the Treasurer approved the recommendation that the CRPTF divest from and restrict future direct investment in the six companies actively engaged in business in the energy sector in Iran, including their wholly-owned and majority-owned subsidiaries. Ms. McClure added that in August 2013, the Treasurer approved the removal of Manpower, Inc. and B/E Aerospace from the MacBride Restricted Company List, and in January 2014, had approved the removal of PPG Industries Inc. and Sally Beauty Holdings - after each company supplied information which demonstrated implementation of the MacBride Principles to the satisfaction of MSCI, the MacBride compliance vendor for the CRPTF.

Chair Thomas called for a motion to accept the report of the CRPTF Compliance Policy for Implementation of Statutory Investment Restrictions. **A motion was made by Mr. Himmelreich, seconded by Mr. Hall, to accept the report of the CRPTF Compliance Policy for Implementation of Statutory Investment Restrictions. Chair Thomas put the question to a vote and the motion passed unanimously.**

Report on Corporate Governance

Laura Jordan, Interim Assistant Treasurer - Policy, reported on corporate governance activities for the quarter ended March 31, 2014. She began with an overview of the proxy voting activity for the first quarter of calendar year 2014, and summarized the results of the CRPTF shareholder resolutions that had been presented at portfolio company annual meetings as of May 31, 2014. Ms. Jordan added that during the first quarter of calendar 2014, all of the international investment managers voted consistently with the CRPTF Global Proxy Policies.

Other Business

Chair Thomas invited the IAC members to submit agenda items for the July 9, 2014 IAC meeting.

There being no further business, Chair Thomas called for a motion to adjourn the meeting. Mr. Thor moved to adjourn the meeting and the motion was seconded by Ms. Carpenter. There being no discussion, the meeting was adjourned at 12:04 p.m.

This meeting was electronically recorded.

Respectfully submitted,

Denise L. Nappier

DENISE L. NAPPIER
SECRETARY

Reviewed by

Carol Thomas

CAROL THOMAS
INTERIM CHAIR