

INVESTMENT ADVISORY COUNCIL  
Wednesday, September 10, 2014

**MEETING NO. 418**

**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  
Laura Jordan, Interim Assistant Treasurer of Policy  
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  
Gustave Christakos, Deutsche Bank  
Frank Gambino, Deutsche Bank  
Will Greene, Loop Capital Markets  
Jonathan Hogstad, Service Employees International Union  
Mark Johnson, Cliffwater, LLC  
Claire Shaughnessy, Hewitt EnnisKnupp, Inc.  
Michael Stark, The Townsend Group  
Kevin Sullivan, BNY Mellon Asset

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 June 11, 2014 IAC Meeting**

Chair Thomas called for a motion to approve the minutes of the June 11, 2014 IAC meeting. **Duke Himmelreich moved to approve the minutes of the June 11, 2014 IAC meeting as drafted. The motion was seconded by William Murray. There being no discussion, the Chair called for the vote. The motion passed unanimously.**

### **Comments by the Treasurer**

Treasurer Denise L. Nappier began her opening remarks with a corporate governance comment concerning the American Federation of Teachers’ (“AFT”) watch list, which had previously included an investment manager of the Connecticut Retirement Plans and Trust Funds (“CRPTF”), K2, in the Alternative Investment Fund (“AIF”). She said a principal of the firm’s parent company, Franklin Templeton, had resigned as a board member of Students First and, consequently, the AFT removed K2 from its watch list. Treasurer Nappier indicated that the Office of the Treasurer had worked in concert with K2 toward the successful resolution.

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 Starwood Global Opportunity Fund X, and also stated that the partnership documents were successfully negotiated and the fund closed on August 13<sup>th</sup>.

Treasurer Nappier next discussed the investment performance of the State Employees’ Retirement Fund (“SERF”) and the Teachers’ Retirement Fund (“TERF”) for the month ended June 30, 2014. She said that both funds experienced strong fiscal year end returns of 15.62% for SERF and 15.67% for TERF; each fund having outperformed its customized benchmarks and exceeded the actuarial assumed rates of return of 8% for SERF and 8.5% for TERF. Treasurer Nappier also noted that the robust fiscal year end performances were led by continued overall growth of assets and vigorous returns for both the SERF and TERF, primarily in the Mutual Equity Fund, with 25.27% for each plan, and the Developed Markets International Stock Fund (“DMISF”) at 22.30%, also for each plan. She said that over the longer term horizon, the 5-year returns remain solid, at 11.90% for SERF and 11.79% for TERF. Treasurer Nappier added that over the course of her administration, market value increases totaled \$19.6 billion, which was inclusive of paying out \$10 billion in benefit payments and a net increase in assets of \$9.6 billion.

Treasurer Nappier next discussed highlights of Fiscal Year 2014, which included competitive searches for currency overlay managers in the DMISF and a Global Inflation Linked Bond panel. She also spoke of the great progress in the REF toward satisfying the allocation target of the Open End Core Fund strategies, having committed \$450 million to the mandate, and remarked on the additional aggregate commitments of \$280 million and \$275 million to other REF and

Private Investment Fund (“PIF”) strategies, respectively.

Treasurer Nappier stated that a presentation on the project plan for a private investment consultant search would be provided. She added that the contract with the current PIF consultant, Franklin Park Associates (“Franklin Park”), would expire in September, 2015 and in accordance with the State’s procurement policy this contract must be put out for bid.

Finally, Treasurer Nappier called attention to a press release regarding the CRPTF’s national award for outstanding performance of its hedge fund portfolio for the past year. For its 12th annual Hedge Fund Industry Awards, *Institutional Investor* magazine recently selected the CRPTF as the winner in the category of Large Public Plan of the Year, having been nominated as a public plan with greater than \$15 billion in assets that demonstrated excellence in absolute return investing in 2013. She said each year, the magazine recognizes public funds that were distinguished in their innovation, achievements and contributions to the hedge fund industry over the previous year. Treasurer Nappier acknowledged Terrence Purcell, Principal Investment Officer (“PIO”) and Lee Ann Palladino, Chief Investment Officer (“CIO”) and the many other individuals within the Treasury that had contributed to the success of the program. She remarked that the Connecticut Treasury continues its commitment to ensuring the soundness of its long-term investment strategy.

**Update on the Market, the Connecticut Retirement Plans and Trust Funds (“CRPTF”) Final Performance for Months Ended June 30 and July 31, 2014**

Lee Ann Palladino, CIO, provided an update on the capital market environment, its impact on the performance of the CRPTF and the economic outlook. She reported that as of June 30, the TERF and SERF, the two largest pension plans, returned 15.67% and 15.62%, respectively, for fiscal year end 2014. Focusing specifically on TERF, she said that the performance was driven by total global equity returns of 21.8%, representing 55% of the portfolio; total fixed income returns of 6.6%, representing 20% of the portfolio; and a 12.3% return for alternative investments, representing 20% of the TERF. Ms. Palladino said the performance remained solid over the longer term horizon with the TERF and SERF returning 11.79% and 11.9%, respectively, over the five year horizon. She then commented on the performance for the first month of fiscal year 2015. Ms. Palladino presented the quarterly performance of the remaining trust plans, noting that trusts that held an asset allocation of 70% core fixed income and 30% equity allocation produced returns of about 9.50% for the various trusts that held this allocation. She then discussed the 2014 legislative amendment of the administration of the Soldiers’ Sailors’ and Marines’ Fund (SSMF), whereby the American Legion will henceforth administer the benefits from the SSMF. Ms. Palladino also noted that the trust assets will continue to be held within the CRPTF and that the SSMF will have a \$2 million annual spending policy. She then compared and contrasted the spending policy to the recent Asset Allocation and Liability Study (“A/L Study”) performed on the SSMF and indicated that the revised spending policy did not materially affect the recommended asset allocation which resulted from the A/L Study.

Finally, Ms. Palladino reported on the Watch List and said that the Treasurer had decided to terminate Ambassador Capital Management, a money manager for the Liquidity Fund. She said the termination was due to the downgrade to “Sell” by general investment consultant, Hewitt EnnisKnupp (“HEK”).

Next, Claire Shaughnessy, Partner of HEK, reported on the Combined Investment Funds (“CIF”) and the Connecticut Horizon Fund (“CHF”) for the quarter ended June 30, 2014. She then discussed a market overview and commented 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. Shaughnessy summarized 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. Shaughnessy reported on the CHF for the period ended June 30, 2014. In addition she said that the fiscal year to date returns were 20.5%, underperforming its benchmark by 50 basis points (“bps”). She said that since inception, the public market CHF returned 7.4%, essentially matching its benchmark.

#### **Consideration of the Search Process for a Private Investment Fund Consultant**

Terrence Purcell, PIO, provided a project plan timeline and evaluation/selection criteria for a PIF consultant. He said that Franklin Park was currently serving as the Private Investment Fund (“PIF”) consultant and they assisted the CRPTF with performing due diligence, quarterly reporting and annual strategic pacing plans. Mr. Purcell said the contract was due to expire September 30, 2015.

Chair Thomas asked for a motion to endorse the search process for a PIF consultant. **A motion was made by Mr. Murray, seconded by Mr. Himmelreich, to endorse the search process for a PIF consultant. There being no discussion, Chair Thomas put the question to a vote and the motion passed unanimously.**

#### **Alternative Investment Fund Review as of June 30, 2014**

Mr. Purcell reported on the Alternative Investment Fund (“AIF”) for the quarter ended June 30, 2014 (absolute return portfolio) and the quarter ended March 31, 2014 (real assets and opportunistic portfolios). His report consisted of an executive summary, 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, who assisted in presenting the quarterly report.

Mr. Purcell reported that as of June 30, 2014, roughly 87% of the AIF's committed capital was allocated to the fund-of-hedge fund portfolio. He stated that the fund-of-hedge fund portfolio had earned 1.62% for the quarter ended June 30, 2014. He noted that this result compared favorably with the HFRI Fund-of-Funds Composite Index return of 1.43%, but modestly trailed the broad HFRI Fund Weighted Composite Index return of 2.06%. Mr. Purcell added that the fund-of-hedge fund portfolio earned 9.80% for the twelve months ended June 30, 2014, outperforming both the HFRI Fund-of-Funds index return of 7.50% and the broad HFRI Fund Weighted Composite Index of 9.11%. 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 March 31, 2014. He stated that the real assets and opportunistic portfolios continued to perform well, and generated a 12.9% combined net internal rate of return since inception. He remarked that an additional \$12.3 million of capital was contributed to the partnerships in the March quarter, bringing the cumulative capital contributions to \$133 million.

Next, Mr. Johnson commented on the fund-of-hedge fund portfolio and general hedge fund industry trends.

#### **Private Investment Fund Review as of March 31, 2014**

Mr. Purcell reported on the PIF for the quarter ended March 31, 2014. He introduced the PIF's consultant, Bradley Atkins, Chief Executive Officer of Franklin Park, who assisted in presenting the quarterly report.

Mr. Purcell presented a portfolio overview as well as benchmark performance and portfolio investment activity. He said the PIF portfolio returned 1.7% for the March quarter and 17.0% for the twelve months ended March 31, 2014, versus gains for the S&P 500 of 1.8% and 22.5% over the same periods. He further commented on the portfolio's 3-year, 5-year and 10-year returns of 10.9%, 14.6% and 9.2%, respectively, versus the S&P 500's returns of 14.3%, 20.9% 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 US buyout and venture capital portfolios by vintage year.

Next, Mr. Atkins reported on the CHF and stated that inception to date returns rose to 4.5% in the March quarter, as the portfolio continued to emerge from the J-curve.

### **Real Estate Fund Review as of March 31, 2014**

Cherie Santos-Wuest, PIO, reported on the performance of the Real Estate Fund (“REF”) for the quarter ended March 31, 2014. She welcomed the REF consultant, Michael Stark, Associate Consultant with Townsend, who assisted in presenting the quarterly report.

Ms. Santos-Wuest reported on the REF’s overall performance, the quarterly as well as the 1,3 and 5-year results, and the portfolio diversification versus investment guidelines and its NCREIF Property Index (“NPI”) benchmark. Ms. Santos-Wuest then reviewed the unfunded commitments, new commitments and new acquisitions for the Core Separate Account and fund vehicles within the REF. She reported that the REF returned 1.0% for the quarter, as of March 31, 2014, and 11.4%, 10.4% and 4.6% on a net basis over the past 1, 3 and 5-year horizons, respectively. She also noted that the REF had outperformed its NPI benchmark by 20 bps over the one-year horizon. Finally, Ms. Santos-Wuest discussed the trending improvement in the REF performance, which she attributes to steady investment in accordance with policy allocation and general partner selection.

Mr. Stark provided the IAC with an overview of the broader real estate markets and commented on capitalization rates, vacancy trends, U.S. labor force growth, and their impact on various sectors of the commercial real estate market.

### **Securities Lending Review as of June 30, 2014**

Frank Gambino, Managing Partner, and Gustave Christakos, Assistant Vice President, of Deutsche Bank (“DB”) reported on securities lending activity for the quarter ended June 30, 2014. Mr. Gambino provided an executive summary comprised of the previous nine months of securities lending activity for the CRPTF. He discussed the seasonal demand for non-US equities and then reported second quarter securities lending returns of 12.07 bps, or \$4.8 million, net of fees, on the \$17.6 billion lendable portfolio. Mr. Gambino also noted that \$3.8 million of those earnings were derived from lending activity and \$1 million was earned from reinvestment of collateral. He said that the cash collateral received as part of the securities lending program was invested in overnight and two month repurchase agreement securities with a weighted average maturity of 16 days. For the nine-month period ended June 30, 2014, the securities lending program earned \$10.3 million in revenue, net of all fees.

Next, Mr. Gambino discussed the market opportunities for securities lending and the types of securities that were of highest interest in this market.

### **Short-Term Investment Fund Review as of June 30, 2014**

Michael Terry, PIO, reported on the performance of the Short Term Investment Fund (“STIF”) for the quarter ending June 30, 2014. Mr. Terry said the STIF earned an annualized yield of 15 bps during the quarter, outperforming its benchmark by 13 bps. He stated that for the twelve

month period ended June 30, 2014, the fund earned an annual return of 14 bps, outperforming its benchmark by 12 bps. He noted that currently the STIF had \$4.1 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 59% 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.

Mr. Terry also provided an economic overview including current information on the economic growth rate, inflation rate and the short-term yield curve.

### **Report on Corporate Governance**

Laura Jordan, Interim Assistant Treasurer - Policy, reported on corporate governance activities for the quarter ended June 30, 2014. She began with an overview of the proxy voting activity for the second quarter of calendar year 2014 and stated that there were 1,328 domestic annual general meetings of portfolio companies and that the CRPTF cast 13,240 votes, of which 73.71% were in support of management recommendations. Ms. Jordan continued that there were 3,195 international meetings at which the CRPTF cast 43,289 votes, of which 86.49% were in support of management recommendations. She summarized the results of the CRPTF shareholder resolutions that had been presented at portfolio company annual meetings as of June 30, 2014. Ms. Jordan added that during the second quarter of calendar 2014, all of the international investment managers voted consistently with the CRPTF Global Proxy Policies. Next, Ms. Jordan discussed the six resolutions that were proposed during the quarter and added that two received a majority vote. Mr. Himmelrich asked how the CRPTF voted on Coca Cola Ms. Jordan responded that votes are consistent with the fund's proxy voting guidelines and are managed by the proxy voting service, ISS.

Chair Thomas called for a motion to accept the Corporate Governance report. **A motion was made by Joshua Hall, seconded by Jan Carpenter, to accept the Corporate Governance report. There being no discussion, Chair Thomas called for a vote and the motion passed unanimously.**

### **Other Business**

Chair Thomas invited the IAC members to submit agenda items for the October 8, 2014 IAC meeting.

Mr. Himmelreich asked that the minutes reflect his expressed gratitude to the recently retired State Auditor, Thomas Willametz, and acknowledged with praise the dedicated service and assistance Mr. Willametz provided to the IAC and to Mr. Himmelreich personally, and also cited the many contributions Mr. Willametz made on behalf of the citizens of Connecticut over his career.

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**There being no further business, Chair Thomas called for a motion to adjourn the meeting. Ms. Carpenter moved to adjourn the meeting and the motion was seconded by Mr. Himmelreich. There being no discussion, the meeting was adjourned at 11:30 a.m.**

**This meeting was electronically recorded.**

**Respectfully submitted,**



**CHRISTINE SHAW  
DEPUTY TREASURER  
for  
DENISE L. NAPPIER  
SECRETARY**

**Reviewed by**



**CAROL THOMAS  
INTERIM CHAIR**