

INVESTMENT ADVISORY COUNCIL
Wednesday, June 8, 2016

MEETING NO. 432

Members present:

Thomas Fiore, representing Benjamin Barnes
Joshua Hall**
Michael LeClair
Steven Muench
William Murray
Denise L. Nappier, Treasurer*
Carol Thomas, Chair

Absentees:

David (Duke) Himmelreich
Peter Thor

Others present:

Richard Gray, Deputy Treasurer
Deborah Spalding, Chief Investment Officer
David Barrett, Director of Communications
Joanne Dombrosky, Principal Investment Officer
Mary Phil Guinan, Assistant Treasurer-Policy
Linda Hershman, Chief of Staff
Wayne Hypolite, Executive Assistant
Catherine E. LaMarr, General Counsel
Christina McGinnis, Executive Secretary
Christine Shaw, Chief Compliance Officer
Michael Terry, Principal Investment Officer-Cash
Linda Tudan, Executive Assistant

*Arrival 9:04a.m.

**Departed 10:30a.m.

Guests:

Albert Adom, The Townsend Group
Waseema Bhura, Intern
Austin Casagrande, Intern
MariLu Cleary, Morgan Stanley
Michael Elio, StepStone Group, LP
Will Greene, Loop Capital Markets
Christopher Keaton, Intern
Pete Keliuotis, Cliffwater LLC
Nicholas Lagasse, Intern
Daria Marvista, Intern
Molly Miller, Intern
Daniel Quirk, Intern
Aditya Raina, StepStone Group, LP
Matt Redeker, StepStone Group, LP
Claire Shaugnessy, AonHewitt Investment Consulting
Diane Smola, AonHewitt Investment Consulting
Michael Stark, The Townsend Group

Ian Takahashi, Intern
Kanzania Thorington, Intern
Arnold West, GIA Partners

With a quorum present, Interim Chair Carol Thomas called the Investment Advisory Council ("IAC") meeting to order at 9:03 a.m.

Approval of Minutes of the April 13, 2016 IAC Meeting

Chair Thomas called for a motion to approve the minutes of the April 13, 2016 IAC meeting. **William Murray moved to approve the minutes of the April 13, 2016 IAC meeting as drafted. The motion was seconded by Thomas Fiore. There was one abstention, Joshua Hall. There being no further discussion, the Chair called for the vote. The motion passed unanimously.**

Comments by the Treasurer

Treasurer Denise L. Nappier began her opening remarks by welcoming the 2016 summer interns working at the Office of the State Treasurer ("OTT") this year. She stated that we consistently received high quality work product from them, which occasionally resulted in interns returning for a second term. Treasurer Nappier noted the diverse backgrounds and interests that each brought to the OTT, and asked that they stand and introduce themselves.

Treasurer Nappier then commented on House Bill 5420 which went before the General Assembly. She said that although the General Assembly had adopted the bill 144-1 in the House and was unanimous in the Senate, the Governor vetoed the amendment. Treasurer Nappier stated that the bill would afford the State Treasurer the same authority regarding the appointment and determination of compensation for the Principal Investment Officers ("PIO") that is granted for the Chief Investment Officer and the Deputy Chief Investment Officer positions. She further added that the bill would direct that the IAC be consulted, provide advice and consent concerning the salary range proffered by the State Treasurer for PIO positions. Treasurer Nappier added that the legislation would be a positive development for the Office of the Treasurer regarding investment personnel issues, specifically by exempting PIO compensation from the current statutory provisions established by the Department of Administrative Services. Treasurer Nappier discussed the agenda and then announced that after having considered feedback from the IAC and the due diligence process conducted by the investment staff and the Private Investment Fund ("PIF") consultant, StepStone Group, she had decided to make a commitment of up to \$100 million to Welsh, Carson, Anderson, & Stowe XII, a PIF opportunity which will primarily focus on upper middle-market opportunities. She added that the negotiation of the partnership agreement was successfully completed within the last two weeks.

Next, Treasurer Nappier commented on the performance of the Connecticut Retirement Plans and Trust Funds ("CRPTF") and said with a few weeks left until the end of the fiscal year 2016, it was apparent that the investment performance would be well below the actuarial assumed rate of return, not unlike many other pension funds throughout the country. Treasurer Nappier then

discussed the investment performance for the two largest pension plans in the CRPTF: the State Employees' Retirement Fund ("SERF") and the Teachers' Employee Retirement Fund ("TERF") for the months ended March 31, 2016 and April 30, 2016.

Lastly, Treasurer Nappier spoke about Corporate Governance and stated that the CRPTF won a significant victory in May at the Annual Shareholder meeting of Connecticut Health Systems. She stated that the CRPTF was the primary filer of a proxy access resolution which would allow eligible shareholders to nominate up to 25% of the board on management proxy boards. She said this resolution passed.

Update on the Market, the Connecticut Retirement Plans and Trust Funds Final Performance for Month Ended March 31, 2015 and April 30, 2016

Deborah Spalding, Chief Investment Officer ("CIO"), provided an update on the capital market environment, its impact on the CRPTF performance and the economic outlook. She reported on the period ended March 31, 2016 and April 30, 2016, for the two largest pension plans, TERF and SERF. For the quarter ended March 31, 2016, the markets were ahead and for TERF, Ms. Spalding said that it had returned 4.08%; versus the benchmark of 5.20% and SERF returned 3.99% versus the benchmark of 5.22%, respectively. Ms. Spalding reported that the Emerging Markets did well in the first quarter and in the third quarter of the fiscal year, and were up 13% for the prior month. For April 30, 2016, focusing specifically on TERF, Ms. Spalding said that it was up 97 basis points ("bps") versus its benchmark of 94 bps and SERF was up 95 bps versus its benchmark of 93 bps. She added that for fiscal year to date, the weakest markets have been equities and the strongest asset classes have been private equity and real estate.

Ms. Spalding commented on the Watch List and stated that the two emerging market equity managers, Aberdeen Asset Management ("Aberdeen") and Grantham, Mayo, Van Otterloo and Company ("GMO"), would not come off of Watch. She stated that Aberdeen's performance had been consistent and positive through the duration on the Watchlist and that GMO had difficult performance periods due to a large exposure to the energy sector. Ms. Spalding commented on the two new additions to the Watchlist, Prudence Crandall III, managed by Rock Creek Group and Prudence Crandall IV managed by K2 Advisors. She said they are considered opportunistic credit strategies that were placed in the Core Fixed Income Fund in early 2014. She explained that at the time of the funds' launch, there was concern that the large Treasury exposure in the Core Fixed Income Fund would underperform in a rate tightening environment and that this opportunistic credit exposure was designed to mitigate that. Next, Claire Shaughnessy, Partner, and Diane Smola, Senior Consultant, AonHewitt Investment Consulting, reported on the Combined Investment Funds for the quarter ended March 31, 2016 and the Connecticut Horizon Fund ("CHF") for the quarter ended March 31, 2016. Ms. Shaughnessy began and provided a market overview with comments on global public market equities and fixed income markets. She also gave economic highlights regarding higher volatility and slowing growth. Ms. Shaughnessy added that the markets were generally positive for the quarter. She commented on inflation and said it remained near zero throughout the Europe, Australasia and Far East region. Lastly, Ms. Shaughnessy spoke about the medium-term views and where the asset classes could be in the next 3-5 years.

Finally, Ms. Smola provided a summary of the returns for the plans and trusts within the CRPTF. She reviewed the performance attribution as of March 31, 2016 for the TERF, SERF and the Municipal Employees' Retirement Fund ("MERF") and said the focus was on longer-term investment results. She commented on the 3-year results in which all three plans slightly outpaced the benchmarks and for the fiscal year to date, in which the plans were outperforming by 15-39 bps. Ms. Smola then gave an overview of the asset allocation and performance on the plans and trusts and stated that most of the trusts have weighted larger allocation to core fixed income.

Ms. Smola then provided a report on the CHF as of March 31, 2016 and said that the CHF returned -0.52%, net of fees, underperforming the customized benchmark, which returned 0.47%. During the first quarter, she stated the CHF underperformed by 100 bps net of fees while since inception there was an underperformance by 50 bps net of fees. Ms. Smola then gave an overview on the public markets, specifically diversity statistics and manager allocation.

Consideration for the Search Process for a General Investment Consultant

Ms. Spalding provided a project plan and timeline and screening/selection criteria for a General Investment Consultant search. She stated that the scope of the consultant mandate will encompass, but not be limited to, assisting with an asset allocation and liability study for each of the State's Plans and Trust Funds and drafting recommended subsequent revisions to the Investment Policy Statement; evaluating and monitoring performance of money managers at public market portfolio and fund levels; conducting due diligence on potential money managers; assessing money managers' environmental, social and governance factors; performing ongoing risk management and compliance functions at the portfolio level; and executing duties associated with oversight of the public market sleeve of the CHF and the investment performance of the Connecticut Higher Education Trust. Ms. Spalding added that the search will be conducted on a competitive basis using the Request for Proposal ("RFP") process. She discussed the screening and selection criteria and the timeline for the search and stated that the RFP would be issued in the month of June 2016 with a response deadline of July 1, 2016.

Chair Thomas called for a motion to endorse the general investment consultant search. **A motion was made by Mr. Murray, seconded by Mr. Hall, to accept the project plan of the general investment consultant search. There being no discussion, Chair Thomas put the question to a vote and the motion passed unanimously.**

Alternative Investment Fund Review as of March 31, 2016

Ms. Spalding reported on the Alternative Investment Fund ("AIF") for the quarter ended March 31, 2016. She introduced the AIF consultant to the CRPTF, Pete Keliuotis, Senior Managing Director. Mr. Keliuotis began and gave an overview of the portfolio, benchmark performance, investment activity and fund level performance.

He reported that as of March 31, 2016, the HFRI Fund Weighted and Fund-of-Funds Composite Index rebounded and returned 1.8% and 1.1%, respectively. He noted that the HFRI Fund Weighted Composite Index returned -0.57%, largely driven by relative value strategies, event

driven strategies, and equity long/short strategies, which provided strong diversification benefits during the quarter. Mr. Keliuotis stated that macro managers were able to capitalize on the heightened volatility in equity markets. He then gave an overview of the CHF portion of the portfolio.

Lastly, Mr. Keliuotis commented on the AIF exposure to real assets and opportunistic investments, noting that the performance results were lagged and as of December 31, 2015. He stated that the net IRR for the program performance since inception was 2.46%. Mr. Keliuotis remarked that \$9.8 million of capital was contributed to the partnerships in the fourth quarter, and \$13.3 million of capital was distributed back to the CRPTF.

Private Investment Fund Review as of December 31, 2015

Ms. Spalding reported on the PIF for the quarter ending December 31, 2015. She introduced the PIF consultant, Michael Elio, Partner of StepStone. Mr. Elio gave an overview of the portfolio including performance, market update and quarterly highlights. He stated that from the program's inception in 1987 through December 31, 2015, PIF had committed \$7.5 billion of distribution and with a market value of \$2.5 billion, which represents approximately 8.6% of the total CRPTF. Since inception, Mr. Elio said PIF's total portfolio had generated a net IRR of 9.1% and that there was a slight drop with the current fund investments with vintages 2002 through 2014, generating a net IRR of 12.0%. He then reviewed the performance by strategy, vehicle and portfolio diversification and stated that for the quarter ending December 31, 2015, the portfolio was primarily concentrated in funds employing buyout strategies, which represented 49.8% of the total exposure with a 94.8% exposure to North America as of quarter-end. Mr. Elio then reviewed the annual cash flow, capital account changes and the benchmark summary.

Real Estate Fund Review as of December 31, 2015

Ms. Spalding reported on the performance of the Real Estate Fund ("REF") for the quarter ended December 31, 2015. She introduced the REF consultant to the CRPTF, Michael Stark and Albert Adom of The Townsend Group. Mr. Stark gave an overview of the market and performance.

He reported that as of December 31, 2015, the REF returned 2.2% net of fees for the quarter, trailing the NPI benchmark of 2.9%. Also, the gross returns of 14.3%, 15.3% and 14.2% were well above the NPI gross returns over the past 1, 3 and 5-year horizons, respectively. Mr. Stark added that the portfolio had consistent positive performance across property types. Additionally, fourth quarter leasing trends were favorable across all of the major property types.

Mr. Stark remarked that the REF was 6.6% of the CRPTF quarter ended December 31, 2015 versus its target allocation of 7%, with \$585 million of unfunded commitments. He added that the core portfolio experienced strong market performance during the quarter and has outperformed the NPI and NFI-ODCE over all time periods. Mr. Stark commented on the diversification, open end funds and detailed different opportunities within the non-core space going forward.

Lastly, Mr. Adom discussed the core portfolio performance and said that the core open end funds made up 51% of the CRPTF's year end 2015 market value, with value add and specialty strategies representing 6% and 3% respectively.

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

Christine Shaw, Chief Compliance Officer, reported on the status of investment restrictions concerning companies doing business in Iran, Northern Ireland and Sudan. Ms. Shaw stated that the three grounds upon which an investment restriction may be based are Federal mandate, State law mandate or Treasurer's discretion and described the specific criteria for all three mandates. She said that the CRPTF's investment managers are contractually required to annually certify that they have conducted a global security risk assessment of any portfolio company that has financial ties or businesses activities in federally designated terrorist sponsoring countries.

Ms. Shaw then gave an update on Iran, Northern Ireland and Sudan, and stated that Iran was still designated as a state sponsor of terrorism by the U.S. Department of State and that commercial activity in the country has been significantly limited. With regard to Northern Ireland, she stated that the CRPTF continued to restrict its managers from investing in two companies for failure to adopt the MacBride principles: Domino's Pizza, Inc. and Yum Brands, Inc., which is unchanged since January 2014. As for Sudan, she remarked that there continues to be a very significant humanitarian crisis in the country and economic instability has worsened by the global depression in oil prices, which has led to substantial civil unrest and ongoing conflict.

Chair Thomas called for a motion to accept the annual report on the Compliance Policy for Implementation of Statutory Investment Restrictions. **A motion was made by Steven Muench, seconded by Mr. Murray, to accept the report on Compliance Policy for Implementation of Statutory Investment Restrictions. There being no discussion, Chair Thomas put the question to a vote and the motion passed unanimously.**

Report on Corporate Governance as of December 31, 2015

Mary Phil Guinan, Assistant Treasurer - Policy, reported on Corporate Governance activities for the fourth quarter of 2015 and the first quarter of the 2016 calendar year. She began with an overview of the proxy voting activity for the fourth quarter, October 1, 2015 through December 31, 2015, and stated that there were 147 annual meetings of domestic portfolio companies and that the CRPTF cast 1,123 votes, of which 73% supported management recommendations. Ms. Guinan continued that there were 480 international meetings held at which the CRPTF cast 3,524 votes; 80% of which were in support of management recommendations.

Ms. Guinan said for the first quarter, January 1, 2016 through March 31, 2016 there were 154 annual meetings of domestic portfolio companies and that the CRPTF cast 1,314 votes, of which 79% were in support of management recommendations. She continued that there were 532 international meetings at which the CRPTF cast 5,730 votes, 87% of which were in support of management recommendations. Ms. Guinan then gave an overview on the shareholder engagement and the 2016 proxy season. She stated that filing of shareholder resolutions had

begun, as did the engagement with companies on issues of importance to the CRPTF, such as American Electric Power & Southern Company and Exxon Mobil. For the 2016 proxy season, Ms. Guinan said the CRPTF filed or co-filed eighteen shareholder resolutions, and reached agreements with five companies, resulting in the withdrawal of those resolutions and the remaining thirteen resolutions going to a shareholder vote. She then commented on access to the proxy, diversity of board membership, climate change and lobbying disclosure.

Chair Thomas called for a motion to accept the report on Corporate Governance activities. **A motion was made by Mr. Murray, seconded by Mr. Muench, to accept the report on Corporate Governance activities. There being no discussion, Chair Thomas put the question to a vote and the motion passed unanimously.**

Short-Term Investment Fund Review as of March 31, 2016

Michael Terry, Principal Investment Officer, reported on the performance of the Short Term Investment Fund ("STIF") for the quarter ending March 31, 2016. Mr. Terry said the STIF earned an average annualized yield of 0.039% during the quarter, outperforming its benchmark by 17 bps, thereby earning an additional \$2.1 million for its state and local government investors. He stated that for the twelve month period ended December 31, 2015 the fund returned 0.23%, outperforming its benchmark by 14 bps, thereby earning an additional \$6.9 million for investors. Mr. Terry noted that the fund was currently at \$5 billion, with a weighted average maturity of 34 days, and daily liquidity, represented by overnight investments and investments available on a same-day basis, totaled \$2.9 billion, or 54% of assets. He said 64% of STIF's assets were invested in securities issued, insured or guaranteed by the U.S. government or federal agencies, money market funds comprised of such securities, or in repurchase agreement backed by such securities, and that its reserves totaled \$51.4 million, or approximately 1% of total assets.

Next, Mr. Terry spoke on the economic review and gave an overview of the market and portfolio performance.

Other Business

Chair Thomas invited the IAC members to submit agenda items for the July 13, 2016 IAC meeting. She reviewed an invoice in the amount of \$1,033.80 from Hudepohl & Associates for expenses related to the Deputy Chief Investment Officer search and requested that it be paid from the IAC budget.

Chair Thomas called for a motion to approve payment of the invoice from the IAC budget. **A motion was made by Mr. Fiore and seconded by Mr. Murray. There being no discussion, Chair Thomas put the question to a vote and the motion passed unanimously.**

Chair Thomas announced that there would not be an August IAC meeting. Lastly, she stated that effective immediately, Michael Kramer had resigned his position as an IAC member.

Comments by the Chair

There being no further business, Chair Thomas called for a motion to adjourn the meeting. **Mr. Fiore moved to adjourn the meeting and the motion was seconded by Mr. Muench. There being no discussion, the meeting was adjourned at 12:00 p.m.**

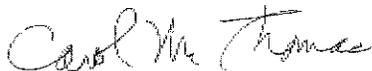
This meeting was electronically recorded.

Respectfully submitted,



**DENISE L. NAPPIER
SECRETARY**

Reviewed by,



**CAROL THOMAS
INTERIM CHAIR**