

**INVESTMENT ADVISORY COUNCIL**  
**Wednesday, May 12, 2010**

**MEETING NO. 376**

**Members present:**

Thomas Barnes  
Thomas Fiore, representing Robert Genuario  
Michael Freeman  
David (Duke) Himmelreich \*  
Stanley (Bud) Morten  
William Murray  
Denise L. Nappier, Treasurer \*\*  
Sharon Palmer \*  
David Roth  
Joseph (Joe) D. Roxe, Chairman  
Carol Thomas

**Absent:**

Peter Thor

**Others present:**

Linda Hershman, Assistant Deputy Treasurer/Chief of Staff  
M. Timothy (Tim) Corbett, Chief Investment Officer  
Lee Ann Palladino, Deputy Chief Investment Officer  
Wayne Hypolite, Executive Assistant  
Catherine LaMarr, General Counsel  
Shelagh McClure, Director of Compliance  
Linda Tudan, Executive Assistant  
Winifred (Winnie) Scalora, Administrative Assistant

**Guests:**

Bradley Atkins, Franklin Park Associates, LLC  
Joseph Barcic, Mercer Investment Consulting  
Rebecca S. Connolly, Fairview Capital Partners, Inc.  
Neil Hickey, Old Mutual Asset Management  
Robin Kaplan-Cho, Connecticut Education Association  
Harvey Kelly, Leumas Advisors  
Louis Laccavole, SOC Teachers' Retirement Board  
Jacqueline Lyons, State Street Bank & Trust  
JoAnn H. Price, Fairview Capital Partners, Inc.  
Alex Thomson, Woodcreek Capital Management

With a quorum present, Chairman Joseph Roxe called the Investment Advisory Council ("IAC") meeting to order at 9:00 a.m.

**Approval of Minutes of the April 14, 2010 IAC Meeting**

Chairman Roxe asked for comments on the Minutes of the April 14, 2010 IAC meeting. **A motion was made by William Murray, seconded by Carol Thomas, that the Minutes of the April 14, 2010 IAC meeting be accepted as drafted. The motion was passed unanimously.**

\* Arrived at 9:04 a.m.

\*\* Arrived at 9:10 a.m.

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**Chief Investment Officer's Update on the Market and the CRPTF Final Performance for the Month Ended March 31, 2010,**

M. Timothy Corbett, Chief Investment Officer ("CIO"), first provided an update on the capital market environment, its impact on the performance of the Connecticut Retirement Plans and Trust Funds ("CRPTF") and the economic outlook. Mr. Corbett began by commenting on the effect that the financial markets have had on diversified portfolios over the last two calendar years, and noted that correlations between asset classes often spiked when the benefits of diversification were most needed. He stated that once investors realized the risk of economic depression had passed, the massive flight to quality unwound. Mr. Corbett commented on the current financial markets and added that the main question was shifting from whether there would be a recovery to how strong the recovery would be and in which sectors. He then remarked about the current major investment themes. In summary, Mr. Corbett said that while risk assets should continue to outperform government bonds and cash, the risk/reward balance had deteriorated since downside economic risks remained, and that he expected significant corrections amid weakening correlations between asset classes.

Mr. Corbett reported on the performance for the CRPTF for the month ended March 31, 2010. He stated that the Combined Investment Funds had increased by 4.5% during March 2010 bringing pension fund assets up to \$23.5 billion, up 19.41% to date for Fiscal Year ("FY") 2010. Mr. Corbett stated that the annualized returns were 7.62% for the trailing seven-year period. He said that the CRPTF continued to perform well against its benchmarks with the Teachers' Retirement Fund ("TERF") and the State Employees' Retirement Fund ("SERF") outperforming their benchmarks over the last three and five years, and that the Municipal Employees' Retirement Fund ("MERF") outperformed its benchmark over the last three years. With respect to the eight public market funds, Mr. Corbett reported that seven outperformed their benchmarks for the month ended March 31, 2010 and that the High Yield Bond Fund had matched its benchmark over the trailing three months. In response to Ms. Thomas' question regarding improvement to the Mutual Equity Fund, Mr. Corbett stated that the Active Extension Products (130% long and 30% short) have helped performance and he expected continued improvement. Chairman Roxe commented about the current high unemployment rate, the high foreclosure rates, and the continued increase in savings rate, as factors which could dampen consumer spending, a primary factor driving U.S. stock prices. Discussion ensued about the economic situation in Greece and the impact the European markets would have on the European economy and the CRPTF.

Michael Freeman commented about the teachers' layoffs during the 2010 and 2011 fiscal years, and discussion ensued about the effect this would have on the TERF. Treasurer Denise Nappier stated that active employee levels had increased to heights last seen in 2002, just prior to the last early retirement program.

**Comments by the Treasurer**

Treasurer Nappier began her remarks by clarifying a statement that was made by Mr. Corbett at the April 14, 2010 IAC meeting that "The CRPTF has fiduciary and financial obligations to two

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key constituencies, plan beneficiaries and generations of taxpayers.” Treasurer Nappier commented that her principal fiduciary duty is solely to the CRPTF beneficiaries. However, she added that with respect to her chief responsibility as a constitutional officer for the management of all funds belonging to the State, she is also responsible to several stakeholders including taxpayers.

Treasurer Nappier then commented about the Actuarial Presentation that was provided at the April 14, 2010 IAC meeting and noted that it was beneficial to understanding the cash requirements and the liability structure for SERF in particular and the CRPTF in general. Treasurer Nappier said the TERF’s cash requirements in FY 2010 have somewhat decreased due to lower capital calls, net of distributions, but the SERF’s cash requirements were exacerbated by a reduction of \$100 million in the State’s annual pension contribution due to the budget agreement between the Governor and the State Employees Bargaining Agent Coalition (“SEBAC”) in FY 2009. In response to Mr. Murray, she stated that the suspension of pension contributions to the SERF would have a negative effect on current cash flow, but added that the pension contributions were deferred and would be amortized over 20 years. Treasurer Nappier stated that the cash requirements for both SERF and TERF were not satisfied through the amount of cash generated by interest and dividend payments, and that the balance of the cash needs would be sourced from the sale of core investments.

Finally, Treasurer Nappier stated that Fairview Constitution IV, L.P. (“Fairview IV”), a PIF opportunity in the venture capital (“VC”) market would be presented. She stated that the CRPTF has been investing in VC funds since 1987 primarily through fund-of-fund vehicles, and that the CRPTF has had a relationship with Fairview Capital Partners, Inc. (“Fairview”) since 2004 when Fairview won the reassignment of Constitution Liquidating Fund I (“Constitution I”) followed by two subsequent VC mandates, Fairview Constitution II, L.P. (“Fairview II”) and Fairview Constitution III, L.P. (“Fairview III”). Treasurer Nappier then commented about the fee arrangements that the OTT had negotiated with Fairview for these fund of funds. Finally, she stated that VC, which has been a core investment of the CRPTF for many years, was the top-performing segment of the PIF and provided access to top-tier funds otherwise not directly accessible for the CRPTF.

**Update on the Cash Flow Report for the Teachers’ Retirement Fund and State Employees’ Retirement Fund**

Lee Ann Palladino, Deputy CIO, provided the results on the FY 2010 Cash Flow Report as of December 31, 2009 for the TERF and SERF. Regarding the TERF, she reported that the overall cash needs were \$77 million less than the \$606.3 million projected in December 2009, primarily due to lower than anticipated capital calls. Ms. Palladino reported that the net outflow of cash for the SERF had increased to \$375 million versus the \$291.4 million originally projected in December 2009. She said that the major cause of the increase in cash requirements for SERF was associated with the \$100 million deferred pension contribution, which was in excess of the \$64.5 million originally projected for FY 2010.

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**Presentation by and Consideration of Fairview Constitution IV, L.P.**

Ms. Palladino provided opening remarks and introduced Fairview IV. She commented about Fairview's strategic fit within the PIF portfolio and why it was well suited to assist the CRPTF with its allocation to VC. Ms. Palladino said that strategically, the Investment Policy Statement ("IPS") parameter for the desired allocation to VC is between 10% and 40%, and the current target was about 20%; investing in Fairview IV would maintain the 20% allocation and allow desired vintage year exposure. She further stated that the IPS indicated that the objective for VC was to earn a return of the Standard & Poor's 500 plus 800 basis points over a 10-year period and that the CRPTF has historically met this target. Ms. Palladino then provided some additional background information on the CRPTF's ongoing relationship with Fairview.

Ms. Palladino commented about the market opportunity for VC and Fairview's track record, and noted that Constitution I has had a 20.2% internal rate of return, a 2.6 multiple and was one of the PIF's best performing funds. She stated that Fairview II and III were similarly structured and as a result were expected to generate top-tier returns over time. Ms. Palladino described Fairview's fees and commented on its track record.

IAC members raised several questions regarding the investment in Fairview which included defining top tier venture capital firms, the ability to access these firms through a fund of fund relationship, how the payment of fees impacts fund-of-fund performance, and the size of the allocation for Fairview IV. In response to those questions, there was a focused discussion concerning the market outlook and suitability of venture capital going forward in meeting the Connecticut Retirement Plans and Trust Funds' (CRPTF) performance expectations, and whether a successor fund to a series of existing venture capital funds in the CRPTF portfolio, as led by Fairview, would be in the CRPTF's best interests.

**Presentation by Fairview Capital Partners, Inc.**

Fairview, represented by Rebecca S. Connolly, Partner, and JoAnn H. Price, Co-founder and Managing General Partner, provided a presentation of Fairview IV. Ms. Price began by providing an overview of Fairview Capital and stated that it was a traditional fund-of-funds manager combining comingled and single client fund of funds for state and municipal funds. She then highlighted Fairview's culture and values. Ms. Price then provided a brief history of Fairview's relationship with the State of Connecticut with respect to the Constitution Fund, Fairview II and Fairview III. She then spoke about Fairview's continuing successful strategy, its ability to invest in high performance funds, to expand the relationship base of next generation funds, and the success of Fairview II and III. Finally, Ms. Price commented that Constitution I has been one of the most successful funds in the United States, and that the CRPTF has been able to further enhance its VC foundation with investments in Fairview II and III.

Ms. Connolly commented about the performance of Fairview II and III, and highlighted its access to top performing funds. She stated that while Fairview II and III were young funds, the early returns for both funds consistently exceeded the median benchmark. Ms. Connolly then detailed

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the progress of Fairview II and noted that it was tracking similarly to Constitution I when that fund was first invested. With respect to Fairview III, she stated that it was also meeting significant milestones, and commented about the progress of the individual companies within the fund. Ms. Price stated that even with the economic downturn over the last 18 months, these portfolios have continued to grow and reallocate distributions. Finally, she commented about Fairview's commitment plan and financial controls.

In conclusion, Ms. Price said that the State of Connecticut has had one of the most prominent and successful VC programs in the United States and she expected this record to continue with Fairview. Ms. Thomas posed a question about Fairview's returns to which Ms. Price stated that the CRPTF has had a consistent high performing VC fund-of-funds program; and she cited Constitution I's performance, and noted that the Fairview Constitution program was a continuous part of the VC program. Ms. Connolly then commented about the returns for VC during the 1990s and the early part of this decade; she stated that the VC market was once again stabilized and that the weak fundraising environment had been a positive for the best venture capital funds. Discussion continued about overall rates of return for the Fairview Constitution program and expectations for future returns and the fee structure. Ms. Price responded to Stanley Morten's questions regarding Fairview's expertise in order to add value by determining and investing in the best sectors of the economy. Ms. Connolly provided an overview on the outlook for various sectors within the VC market.

**Roll Call of Reactions for Fairview Constitution IV, L.P.**

Chairman Roxe asked IAC members to provide input on the investment in Fairview Constitution IV, L.P., but first stated that there was a lot of money being invested on behalf of the CRPTF by Fairview and asked if other firms were considered to enable more diversification within the VC space. Treasurer Nappier first addressed the diversification issue and noted that Fairview redeployed investment dollars into sub-fund managers, and therefore the CRPTF's exposure to VC was diversified. She also highlighted the benefits of the Fairview fund-of-fund vehicle stating it was a separate account that enabled flexibility for the CRPTF to meet its statutory obligations. Treasurer Nappier reminded the IAC that the process for bringing Fairview IV before the IAC was consistent with the process used for all illiquid funds and the proper vetting process was followed. In response to Sharon Palmer, Ms. Palladino stated that Fairview's fee structure and performance were reviewed to ensure it was competitive compared to other fund-of-fund managers.

Thomas Fiore, David Himmelreich, Messrs. Murray, Morten, and Freeman, David Roth, Thomas Barnes and Chairman Roxe felt that the performance of the Fairview Constitution Funds had been marginal, since only 46 percent of the funds have been performing above the median and 54 percent have been performing below the median, and that we run the risk of having too many eggs in one basket by making an additional investment with the firm. Chairman Roxe pointed out that the commitment to Constitution I is \$640 million, of which \$187 million was remaining value and \$9 million unfunded commitments for a total exposure of \$196 million (Fairview took over management of this fund from the original manager), \$200 million was committed to Constitution II in 2005, and of that amount \$77 million remains to be deployed and \$105 million of remaining

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value for a total exposure of \$182 million, and \$300 million was committed in 2007, of which \$268 million remains to be deployed and \$30 million of remaining value for a total exposure of \$298 million. Chairman Roxe said that the Council felt that adding an additional commitment of \$150 million for Constitution IV would make for too large a total investment and that the Treasurer should explore other alternatives for this portion of the CRPTF's VC investment allocation.

Madams Palmer and Thomas were supportive of the investment.

**Other Business**

Chairman Roxe invited IAC members to submit agenda items for the June 9, 2010 IAC meeting.

**Comments by the Chairman**

Chairman Roxe complimented the members of the IAC for their good work and insightful comments and questions during the meeting.

There being no further business, the meeting was adjourned at 11:45 a.m.

**An audio tape of this meeting was recorded.**

**Respectfully submitted,**



**DENISE L. NAPPIER**  
**SECRETARY**

**Reviewed by**



**JOSEPH D. ROXE**  
**CHAIRMAN**