INVESTMENT ADVISORY COUNCIL
Wednesday, September 14, 2011

MEETING NO. 388

Members present:	Thomas Barnes Thomas Fiore, representing Benjamin Barnes* Michael Freeman**** Laurence N. Hale David (Duke) Himmelreich** William Murray Denise L. Nappier, Treasurer*** Joseph (Joe) D. Roxe, Chairman Carol Thomas
Absent:	Stanley (Bud) Morten Sharon Palmer Peter Thor
Others present:	Jonathan Harris, Deputy Treasurer Christine Shaw, Chief of Staff Lee Ann Palladino, Interim Chief Investment Officer Gary Carter, Interim Deputy Chief Investment Officer Joanne Dombrosky, Principal Investment Officer Gregory Franklin, Assistant Treasurer Adrian Kingshott, Principal Investment Officer Donald Kirshbaum, Investment Officer-Policy Catherine LaMarr, General Counsel Reginald Tucker, Investment Officer Linda Tudan, Executive Assistant Lawrence Wilson, Assistant Treasurer Winifred (Winnie) Scalora, Administrative Assistant
Guests:	Bradley Atkins, Franklin Park Associates Scott Booth, The Townsend Group Jeanna Cullins, Hewitt EnnisKnupp, Inc. Mary Dunleavy, State Street Bank & Trust Greg Fox, Hewitt EnnisKnupp, Inc. Sean Gill, NEPC Will Greene, Loop Capital Markets Harvey Kelly, Leumas Advisors Louis Laccavole, SOC Teachers' Retirement Board Tania Naaman, BNY Mellon Michael Scotto, Hewitt EnnisKnupp, Inc. Johnson Shum, State Street Bank & Trust Nick Stanojev, BNY Mellon Alex Thomson, Wood Creek Capital Management, LLC

* In at 9:07 a.m.
** In at 9:09 a.m.
*** In at 9:18 a.m.
**** In at 9:38 a.m.

Kevin Vandolder, Hewitt EnnisKnupp, Inc.

Chairman Joseph D. Roxe called the Investment Advisory Council ("IAC") meeting to order at 9:03 a.m. He said that the Minutes of the August 10, 2011 IAC meeting would be approved once a quorum was met.

Chief Investment Officer's Update on the Market, Connecticut Retirement Plans and Trust Funds Final Performance for the Month Ended July 31, 2011, Combined Investment Funds Review as of June 30, 2011, CRPTF Watch List and Connecticut Horizon Fund Review for the Quarter Ended June 30, 2011

Lee Ann Palladino, Interim 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 began by summarizing the economic activity during the first few months of Fiscal Year ("FY") 2012. She commented on the deteriorating prospects for world-wide economic growth and declining confidence in the European policy makers to resolve the European debt crisis, which had caused uncertainty, volatility and a worldwide equity market decline.

Regarding the performance of the CRPTF for the month ended July 31, 2011, Ms. Palladino reported a loss of 53 basis points ("bps"). She stated that equity markets fell due to policy concerns in the US and debt markets posted positive gains as a result of falling interest rates and a flight to quality.

Ms. Palladino next commented on the European debt situation, the catalyst for recent market volatility, which had occurred due to the misalignment of monetary and fiscal policies. She noted three major concerns: (i) the risk of contagion beyond Greece, (ii) the financial stress on banks that lent money to European countries that are under financial stress, and (iii) the risk of a liquidity crisis. Ms. Palladino added that the European debt crisis was a very complicated and challenging policy issue and until a practical resolution is in sight, the global markets would continue to dislocate and be volatile.

In response to William Murray, Ms. Palladino said that the US is in a mode of deleveraging and during these times fiscal and monetary policy are ineffective tools to promote economic growth. She stated that deleveraging occurs due to an imbalance between lending activities and the ability to repay. She further stated that fiscal and monetary policy help to take the sting out of the deleveraging process, but the markets will not be financially stable until the imbalances are restored. David Himmelreich asked if there was a way to mitigate the affects of another economic crisis similar to that of 2008. Ms. Palladino responded by noting that Part I of the Investment Policy Statement ("IPS") recognizes that the Treasurer can take action if an opportunity should arise provided this action is approved in advance by the IAC. Treasurer Nappier said that the CRPTF's asset allocation included a provision for risk tolerance and she noted that this would be further addressed during the upcoming Asset Allocation Study. The Treasurer then said that she would not move to liquidate a sizable portion of the portfolio as a result of violent market conditions because that would be driven by emotion and not by sound, strategic thinking. Lawrence Hale asked whether there was enough liquidity to handle another downturn to which Ms. Palladino affirmatively responded and noted that the Liquidity Fund is one of the OTT's strategic initiatives. Chairman Roxe commented on the important questions raised by Messrs. Hale and Himmelreich. Chairman Roxe requested that actual definitions of the Liquidity Fund Tiers I, II and III be included in the footnotes.

Ms. Palladino next stated that no firms were on the CRPTF Watch List as of June 30, 2011, but added that the contract for Artio Global Management, LLC, (a core Developed Market International Stock Fund manager) would be allowed to expire on September 30, 2011.

Next, Ms. Palladino spoke about the Asset Liability Study, and stated there were key strategic objectives that must be addressed in order to properly allocate assets. She discussed at length the importance of liquidity requirements, addressing the funding profile of the two largest plans, determining the appropriate risk tolerance, and finally allocating assets based on this input. Ms. Palladino concluded by saying, that given these circumstances, the potential portfolio returns would likely be less than the actuarially recommended rate of 8.5% and 8.25%. In closing, Ms. Palladino discussed the one-year timeline of the Asset Liability Study, which included phases for strategic planning, information gathering, conducting the asset/liability modeling, and revising the IPS.

Next, Ms. Palladino welcomed Jeanna Cullins, Michael Scotto and Kevin Vandolder, Principals of Hewitt EnnisKnupp, Inc. ("EnnisKnupp"), who provided the overall investment results for the Combined Investment Funds ("CIF") and an update on the Connecticut Horizon Fund ("CHF") for the fiscal year ended June 30, 2011. Mr. Vandolder began by providing an economic update. In response to Chairman Roxe, Mr. Vandolder stated that there was about a 33% probability that there will be less than 2% growth in gross domestic product ("GDP"), which would lead to a stall in terms of global economic activity and a recessionary environment. Chairman Roxe noted that corporations were financially strong, but lacked consumer demand.

Mr. Scotto then reported on the fund performance for the CIF and discussed each of the combined investment funds. Mr. Scotto then discussed the CHF for the fiscal year ended June 30, 2011. He reported that the CHF underlying funds outperformed the benchmark over every tracked period, and that it increased by 29% during FY 2011. Chairman Roxe questioned the international equity performance of one manager and noted that the manager needed to be watched closely. Mr. Vandolder stated that individual managers that did not perform well would be analyzed in much greater detail.

<u>Approval of Minutes of the August 10, 2011 IAC Meeting</u>

With a quorum present, Chairman Roxe asked for comments on the Minutes of the August 10, 2011 IAC meeting. **There being no comments, a motion was made by Mr. Murray, seconded by Michael Freeman, that the Minutes of the August 10, 2011 IAC meeting be accepted as drafted. The motion was passed with the exception of Thomas Barnes and Carol Thomas who abstained due to their absence from the last meeting.**

Comments by the Treasurer

Treasurer Nappier commented on recent current events. She reflected on the 10th anniversary of the September 11, 2001 terrorist attacks and commented on the affect this event had on the U.S. economy and specifically noted the resilience of institutional investors. In remembering the 9/11 attack, Treasurer Nappier compared that event to today's European debt crisis and said that as a long-term investor it was important to focus on generating performance throughout the market cycle and not on the short-term gyrations which can cause overreactions to market volatility. She said that as an institutional investor, it is not simply about generating a better investment return, but the need to be cognizant of the primary object to provide benefits to retired workers. Turning back to 9/11, Treasurer Nappier reminded the IAC that the first responders were public employees, just like the beneficiaries of the CRPTF, and it was a worthy reminder of the important role a sound pension program plays to provide pension payrolls for those that have served the public selflessly.

Next, Treasurer Nappier announced that Gary Carter was appointed as Interim Deputy CIO until that position is permanently filled. She said that Mr. Carter has over 35 years of financial services experience in the management and monitoring of large, diversified investment portfolios. Treasurer Nappier noted that Mr. Carter previously worked at the Office of the Treasurer and briefly served as CIO.

Treasurer Nappier then announced her investment decisions reached after considering the feedback from the IAC and the due diligence reports from investment staff and the CRPTF's consultants. She said that she decided to commit up to $65 million to ArcLight Energy Partners Fund V, L.P. ("ArcLight V"), an AIF opportunity that primarily focuses on North American investments in energy infrastructure assets. Next, Treasurer Nappier reported that she selected Callan Associates Inc. as the preferred vendor to provide assistance in the procurement of a global Master Custodian for the CRPTF, and she noted that this search was conducted through a competitive "Request for Proposal" process. As with all hiring decisions, she added that both of these were contingent upon successful contract negotiations.

In closing, Treasurer Nappier publicly thanked former IAC member, David Roth for his service and dedication to the IAC. She noted that Mr. Roth had served from July 2003 to June 2011, a total of eight years, and she viewed him as an asset to the Treasury.

Securities Lending Review as of June 30, 2011

Johnson Shum, Vice President of State Street Bank, provided a review of securities lending activity for the quarter ended June 30, 2011. Mr. Shum first provided an earnings and performance review and reported that during FY 2011, securities lending generated $16.3 million approximately 4% more than was generated during the same period of the prior year. The quarter over quarter increase was driven by the U.S. equities and corporate bond programs. He next commented on the top ten borrowers and noted that there were no major changes since the prior fiscal year end and that the average balances remained fairly steady with an overall on-loan balance of $3.3 billion as of June 30, 2011. In response to Ms. Palladino's question, Mr. Shum noted that there were set limits for the individual borrowers and that in the event of a borrower default, State Street would cover the losses. In summary, Mr. Shum commented on the European debt crises and noted that State Street had put limits of 30 days on European banks. In terms of strategy, Mr. Shum stated that State Street was keeping maturities inside three months and was focusing on United Kingdom, Nordic, Canadian and Australian banks and avoiding mainland European banks until the situation in Greece became clearer. In response to Chairman Roxe, Mr. Shum said that the European dividend season during 2011 was very strong with higher dividends than expected contributing to the increased earnings.

Real Estate Fund Review as of March 31, 2011

Scott Booth, Principal of The Townsend Group, provided a report on the Real Estate Fund ("REF") for the quarter ended March 31, 2011. Mr. Booth reported that the net time-weighted return was 4.9% gross and 4.3% net total return for the quarter, which compared favorably to the index return of 3.4%. He said that this reflected a positive trend of improvement in the market value, and an indication of a rebound in the commercial real estate market. Mr. Booth stated that this represented a 17% gross and 14.5% net one-year return. He added that this did not imply a broad-based recovery because there continued to be areas of weakness across the real estate market. Mr. Booth reported that the one-year cash-on-cash yield was 11.5% and that approximately $27 million of the $1 billion REF portfolio was distributed to CRPTF during the quarter ended March 31, 2011. Since inception of the REF, Mr. Booth reported that the REF portfolio's net time-weighted return was positive 4.4%. He added that the program was reflective of the recovering market and that he did expect this positive trajectory to continue. With respect to the risk profile, he reported that the sectors of real estate within the REF included core at approximately 33%, value-added at approximately 25% and opportunistic at approximately 42%. With respect to leverage, Mr. Booth stated that the cap was 60% for overall leverage and that the REF was currently levered at 55%, a comfortable position.

In closing, Mr. Booth said that despite the recovery in core real estate, capitalization rates, defined as the initial income yield for a property, have remained well above the yield on the ten year Treasury, a historic spread level. He commented that the recovery in the real estate market was bifurcated with pockets of strengths, but the secondary and tiertiary markets still had significant vacancies. In response to Chairman Roxe, Mr. Booth said that banks were using a very slow, well-managed foreclosure process. He added that the number of banks that were still overwhelmed by foreclosures decreased.

Private Investment Fund Review as of March 31, 2011

Adrian Kingshott, Principal Investment Officer, reported on the PIF for the quarter ended March 31, 2011. Bradley Atkins, Chief Executive Officer of Franklin Park Associates, provided additional comments on the Private Investment Fund ("PIF") and the CHF. Mr. Kingshott began by reporting that the PIF returned 4.5% for the quarter ended March 31, 2011 due to a stronger equity market. He also reported that the PIF had receipts of $128 million versus disbursements of $87 million, a positive balance of payments. With respect to the overall state of the private equity market, Mr. Kingshott said that the general disposition among the General Partners was bullish, in spite of the continued slow growth rates in the economy. He added that a slow growth environment, with exceptionally low interest rates, was viewed as a satisfactory backdrop for incumbent General Partners who were requesting investments in follow-on funds.

In response to questions posed at the June 8, 2011 IAC meeting, Mr. Atkins commented about private equity return calculations and the impact of cash flow timing, fees and expenses on net return. He highlighted a few funds within the PIF portfolio to demonstrate how the funds were impacted by fees and their affect on the net return. Mr. Atkins stated that the typical fee structure included an approximate charge of 2% per year on committed capital for the first five years followed by a charge of about 1.5% on net invested capital. He said that there was also an additional carry charge as a profit incentive to the fund manager with the CRPTF earning 80% and the General Partner earning 20% of profits. Mr. Atkins noted that the reason negative returns are typically reported in the earlier years of a fund's life is because a substantial portion of called capital goes to fees and expenses during that time frame. In response to Mr. Fiore, Mr. Atkins said that the time-weighted return, which is net of expenses, is reported on the OTT's CRPTF report. Discussion ensued about time weighted returns and the market value of the funds. Mr. Atkins compared two funds that reported similar returns and noted that the actual capital returned for the two funds was very different; therefore, it was important not to draw conclusions on early reported returns. Next, Mr. Atkins commented on management fees that were charged by the PIF managers during FY 2010.

Mr. Atkins then reported on the CHF portfolio that included three underlying Fund-of-Funds in private equity. He stated that there were total commitments of $155 million in these funds and about $4.01 million had been paid out in fees to date. Overall, Mr. Atkins stated that the CHF portfolio was young and that the negative net IRR would improve over time.

Alternative Investment Fund Review as of June 30, 2011

Mr. Kingshott introduced Sean Gill, Head of Alternatives, NEPC, who reported on the performance of the AIF for the quarter ended June 30, 2011. Mr. Gill stated that the AIF is still in the process of being constructed. In terms of the quarter ended June 30, 2011, he reported that returns were mildly negative and the CRPTF's portfolios declined approximately 70 bps, which was above the Fund-of-Funds Index which was down approximately 120 bps for this time horizon. Mr. Gill then commented on the performance of the various underlying hedge fund strategies. It was reported that, in aggregate, the portfolio was approximately 129% long and 87% short with a net exposure approximately 43%, which was in line with expectations.

Mr. Kingshott remarked about more recent events within the hedge fund markets noting that the massive correlation of asset classes did hurt hedge funds performance and that August 2011 was a difficult month. Generally speaking, he reported that the portfolio declined 2.6% in aggregate compared to the S&P, which was down 5.43%, and he noted that the portfolio reduced overall volatility. Chairman Roxe remarked about the portfolio's liquidity, and he noted that about 50% of the invested capital could be returned within six months.

<u>Short-Term Investment Fund Review as of June 30, 2011</u>

Lawrence Wilson, Assistant Treasurer, reported on the performance of the Short-Term Investment Fund ("STIF") for the quarter ended June 30, 2011. Mr. Wilson reported that the STIF had an average annualized yield of 21 bps versus its benchmark of 4 bps, which is the industry standard of similar first-tier institutional rated money market mutual funds, thereby earning an additional $2 million for state and local governments investing in the STIF. For the fiscal year ending June 30, 2011, he reported that the STIF had an annual return of 23 bps versus its benchmark of 8 bps, thereby earning an additional $7.4 million for the STIF. Mr. Wilson stated that the STIF had maintained its conservative investment posture with one-day liquidity of approximately 67% of assets and that the weighted-average maturity was 29 days. He reported that 35% of the portfolio was invested in securities issued, guaranteed or insured by U.S. government of federal agencies or in repurchase agreements back by such securities. He concluded his presentation by noting that the STIF's reserves totaled $44 million or approximately 0.9% of assets. Chairman Roxe provided positive feedback on the report.

<u>Comments by the Chairman</u>

Chairman Roxe read the following resolution on behalf of former IAC member David Roth.

WHEREAS, *the protection and growth of the assets of the Connecticut Retirement Plans and Trust Funds (CRPTF) is 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 David Roth for his outstanding contributions as a member of the Investment Advisory Council from July 2, 2003 through June 30, 2011; and*

WHEREAS, *during his tenure, Mr. Roth meaningfully contributed to comprehensive revisions to the Investment Policy Statement, enabling the CRPTF to become more strategic in its investments, while maintaining a diversified portfolio that increased assets with prudent risk exposure; and*

WHEREAS, *his commitment to serve the people of Connecticut was demonstrated in his long-standing support for fully funding the State's pension obligations and for his leadership of the Investment Advisory Council in publicly endorsing the Treasurer's efforts to reduce the unfunded liability portion of the Teachers' Retirement Fund, resulting in the sale of $2 billion in Pension Obligation Bonds, which strengthened the financial health of the Teachers' Retirement Fund; and*

WHEREAS, *Mr. Roth's business experience in real estate was of immeasurable benefit in the establishment of sound real estate investment policies that will guide the CRPTF for years to come; and*

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

WHEREAS, *his 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 David Roth during his service as a member of the Council.*

Given the 14th day of September, 2011.

A motion was made by Mr. Murray, 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 David Roth during his service as Chair and as a member of the Council. The motion was passed unanimously. The resolution was signed by Treasurer Nappier and Chairman Roxe.

Other Business

Ms. Palladino provided a review of the IAC budget for the fiscal year ended June 30, 2011. She noted that the IAC was under budget due to savings in commuter costs, meeting costs and travel. Chairman Roxe invited IAC members to submit agenda items for the October 12, 2011 IAC meeting.

There being no further business, the meeting was adjourned at 11:38 a.m.

This meeting was recorded on audio tape.

Respectfully submitted,

Denise L. Nappier

DENISE L. NAPPIER
SECRETARY

Reviewed by

J. Roxe

JOSEPH D. ROXE
CHAIRMAN