

**INVESTMENT ADVISORY COUNCIL
WEDNESDAY, December 10, 2008**

MEETING NO. 362

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
Carol Thomas
Peter Thor**

Absent:

James Larkin, Chairman

Others present:

Howard G. Rifkin, Deputy Treasurer
Linda Hershman, Assistant Deputy Treasurer/Chief of Staff
Lee Ann Palladino, Acting Chief Investment Officer
Joanne Dombrosky, Principal Investment Officer
Gregory Franklin, Assistant Treasurer-Investments
David Holmgren, Principal Investment Officer
Wayne Hypolite, Executive Assistant
David Johnson, Principal Investment Officer
Donald Kirshbaum, Investment Officer
Catherine LaMarr, General Counsel
Shelagh McClure, Director of Compliance
Jason Price, Principal Investment Officer
Christine Shaw, Director of Government Relations
Linda Tudan, Chief Executive Assistant
Lawrence Wilson, Assistant Treasurer-Cash Management
Winifred (Winnie) Scalora, Administrative Assistant

Guests:

Bradley Atkins, Franklin Park
Joseph Barcic, Mercer Investment Consulting
Makaiya Brown, Mercer Investment Consulting
Richard Charlton, New England Pension Consultants
Jaeson Dubrovay, New England Pension Consultants
Sean Gill, New England Pension Consultants
Robyn Kaplan-Cho, Connecticut Education Association
Harvey Kelly, Leumas Advisors
Michael McDonald, Bloomberg News
William Monagle, Jr., New England Pension Consultants
Julie Naunchek, CSEA-Retiree Council #400

*Arrived at 9:03 a.m.

**Arrived at 9:05 a.m.

***Arrived at 9:09 a.m.

Claire Shaugnessy, Rogerscasey
Cynthia Steer, Rogerscasey

Due to the absence of Chairman James T. Larkin, David Roth chaired the Investment Advisory Council (“IAC”) meeting. With a quorum present, Mr. Roth called the IAC meeting to order at 9:02 a.m.

Approval of Minutes of the November 12, 2008 IAC Meeting

Mr. Roth asked for comments on the Minutes of the November 12, 2008 IAC meeting. **There being no comments, a motion was made by Carol Thomas, seconded by Stanley Morten, that the Minutes of the November 12, 2008 IAC meeting be accepted as drafted. The motion was passed unanimously.**

Approval of Minutes of the November 13, 2008 Special IAC Meeting

Mr. Roth asked for comments on the Minutes of the November 13, 2008 IAC special meeting. **There being no comments, a motion was made by Ms. Thomas, seconded by William Murray, that the Minutes of the November 13, 2008 IAC special meeting be accepted as drafted. The motion was passed unanimously.**

Comments by the Treasurer

Treasurer Denise Nappier began her opening remarks by wishing everyone happy holidays and a prosperous 2009. She then thanked the IAC members for attending last month’s two IAC meetings and said that the time and effort the IAC members invested in reviewing the many opportunities that were presented during the meetings was appreciated. Treasurer Nappier noted that while she could not be present for the entirety of both days, she was briefed by her staff and reviewed the minutes including Chairman Larkin’s presentation. She stated that as an ex-officio member of the IAC, she commended Chairman Larkin on his thoughtful and thorough presentation and she supported many of his points unequivocally, including his compliments extended to the Treasury staff. Regarding Chairman Larkin’s description of the system of pension fund governance, Treasurer Nappier stated that she did not agree with some of his statements, which she would explain at the January 14, 2009 IAC meeting.

Treasurer Nappier then provided an update on the recent decisions that she had made. Regarding the Liquidity Fund (“LF”) Tier II money managers, Treasurer Nappier reported that after considering the feedback from the IAC, the consultants, Pension Fund Management (“PFM”) staff and the due diligence process, she was pleased to announce that she had authorized a \$75 million investment each to Ambassador Capital Management and Payden & Rygel, and a \$200 million investment to Pacific Investment Management Company LLC (“PIMCO”). She noted that all three managers employed an enhanced cash, short-duration management style and all complemented each other as Tier II managers. Treasurer Nappier also reported that after considering the feedback from the IAC, the consultants, PFM staff and the due diligence process, she was pleased to announce that she had authorized a \$175 million investment each to

Colchester Global Investors and Lazard Asset Management LLC, both as LF Tier III money managers. She stated that the award of the mandates for all five of the LF money managers was contingent upon successful contract negotiations.

Treasurer Nappier reported that after considering the feedback from the IAC, PFM staff, Franklin Park and the due diligence process, she decided to authorize a commitment of \$35 million to Leeds Equity Partners V (“Leeds V”), contingent upon successful completion of contract negotiations.

Finally, Treasurer Nappier reported on her decision regarding the six finalist firms for the transition management panel that presented at the November 13, 2008 IAC meeting. She stated that the six finalists were vetted by PFM staff and the consultant, and after considering the due diligence process and the feedback of the IAC, she decided to hire all six firms as a panel: Barclays Global Investors, N.A.; BlackRock, Inc.; BNY ConvergeEx Group; Northern Trust Securities, Inc.; Russell Investments Group and State Street Global Markets, LLC, pending successful completion of contract negotiations.

Turning to today’s agenda, Treasurer Nappier stated that the IAC members would be asked to consider the proposed revisions to the Investment Policy Statement (“IPS”). She noted that the main purpose for this revised draft was to set forth guidelines for the Connecticut Retirement Plans and Trust Funds’ (“CRPTF”) new Alternative Investment Fund (“AIF”). She then thanked all of the IAC asset allocation subcommittee members for their input to the AIF guidelines within the working draft IPS, all of which she accepted during the preliminary drafting phase. Treasurer Nappier stated that the purpose of the discussion today was to serve as the official submission of proposed changes to the IPS as part of the approval process and that she looked forward to receiving any additional feedback from the IAC members. She further noted that public notice of the proposed revisions was made on November 25, 2008. Treasurer Nappier added that the proposed changes to the IPS were posted on the Office of the Treasurer’s website.

Regarding the CRPTF’s Sudan initiative, Treasurer Nappier stated that Shelagh McClure, Compliance Officer, would provide an update. Finally, she said that today’s meeting would conclude with a review of the quarterly reports.

Ms. Thomas raised a question about the liquidity situation of the CRPTF noting that some public pension plans were experiencing a lack of liquidity. Treasurer Nappier remarked that an updated cash flow analysis would be presented at the next IAC meeting. She also noted that the LF strategically increased the percentage of cash within each plan and was launched coinciding with the receipt of proceeds from the \$2 billion Pension Obligation Bond sale, so the CRPTF’s cash flow was being maintained, unlike that of many other peers.

CRPTF Final Performance for the Month Ended October 2008

Lee Ann Palladino, Acting Chief Investment Officer (“CIO”), provided a report on the CRPTF’s performance for the month ended October 31, 2008. She stated that the CRPTF had registered significant losses in market value during the challenging 2009 fiscal year but performance results

were above each fund's customized benchmark. Ms. Palladino then noted that the U.S. and global economy were in the midst of a synchronized recession and as a result, consumer spending, which represented two thirds of the U.S. Gross Domestic Product, had slowed and the lack of growth coupled with the extreme market volatility put significant downward pressure on the performance of the CRPTF's equity securities. Additionally, she said that the credit markets remained frozen in October, putting significant downward pressure on the fixed income performance results. Ms. Palladino commented that October was one of the most turbulent months in history and the one month loss for the CRPTF was 11.93%. She continued that following the loss of 7.70% in September 2008, the fiscal year-to-date loss for the CRPTF was 19.49% and the market value as of October 31, 2008 was \$20.7 billion down from \$25.9 billion at the end of the fiscal year ended June 30, 2008.

Ms. Palladino then provided highlights for the month of October with a focus on fixed income securities. In response to Mr. Roth's question, she said that the market value decline in the fixed income funds was a mark-to-market issue as opposed to recognized losses on defaulted securities.

Ms. Palladino then reported that the Teacher's Retirement Fund ("TERF") posted a loss of 19.27% versus its benchmark's loss of 23.45%, an out-performance of 418 basis points ("bps") for the fiscal year-to-date, noting the performance versus benchmark was widening over the past few months. Ms. Palladino explained that the strong performance above benchmark for TERF, as well as the State Employees' Retirement Fund ("SERF") and the Municipal Employees Retirement Fund ("MERF") will return to more normal levels as the lag in the repricing of market values of private equity and real estate are recorded. In response to Mr. Freeman's question, Ms. Palladino stated that the market value for the TERF was about \$14.8 billion as of June 30, 2008.

Ms. Palladino reviewed the liquidity position for each of these funds and noted that the SERF had 6.2% invested in the LF versus its target of 4%, near its upper range of 7%. She stated that the MERF had 6.6% in the LF, putting it above both its policy target and its upper limit. Finally, Ms. Palladino said that the TERF had 9.4% invested in the LF, above its target of 6% and near its upper range of 10%.

In summary, Ms. Palladino stated that cash was well managed for all of the plans and trusts. She said that with respect to the rebalancing, all funds were within their policy ranges with the exception of emerging market equities.

Update on CRPTF Watch List

Ms. Palladino provided an update on the status of the managers on the CRPTF Watch List. She reported that State Street Global Advisors ("SSGgA") was on the Watch List for organizational concerns and that Trust Company of the West ("TCW"), INVESCO Global Asset Management ("INVESCO") and Western Asset Management ("WAMCO") were on the Watch List for performance concerns. Ms. Palladino provided an update on each Watch List money manager.

Ms. Palladino also provided Mercer's ratings on each of the managers. She responded to the IAC members' questions about the provisional rating and performance reporting for these Watch List money managers. Discussion ensued about the process of managing Watch List managers and loss recovery. An IAC member requested that the Watch List Review show clients gained and lost.

Consideration of the Treasurer's Proposed Revisions to the Investment Policy Statement

Ms. Palladino presented Treasurer Nappier's recommended revisions to the IPS for review by the IAC and noted that Treasurer Nappier recapped the recommended revisions during her opening comments. She then reviewed the statutory requirements for IPS adoption and approval and stated that any recommended changes from the IAC members, if any, should be approved by a majority and would also be posted publicly. Finally, Ms. Palladino said that the revisions to the IPS would be adopted by the Treasurer, and at a subsequent meeting of the IAC the IPS would be presented for the consideration and approval of the IAC members.

Mr. Roth opened the floor for discussion regarding the amendments or modifications that were made to the IPS and invited the IAC members to voice their concerns. Ms. Thomas stated that the Asset Allocation Subcommittee reviewed the draft IPS language in detail and reached unanimity on most points with consensus on all. The IAC members agreed that this was a lengthy process and thanked Ms. Thomas for her effort. Mr. Roth stated that there were no requests for changes to the Treasurer's proposed revisions to the IPS.

Report on CRPTF Sudan Initiative

Shelagh McClure, Director of Compliance, provided information on the CRPTF Sudan Initiative. She reported that the Treasurer decided to take action under Connecticut's Sudan Statute, Conn. General Statute Section 3-21e, to divest CRPTF funds from and prohibit further investment in two companies, Petronas Capital Ltd. and Wartsila Oyj Corporation. Ms. McClure stated that a 90-day notice of divestment action was given to the companies and that notification of the Treasurer's action was given to the Department of Justice, each pursuant to federal law. She also stated that in November 2008, letters were sent to several companies seeking information on their activities in Sudan.

Connecticut Horizon Fund Review as of September 30, 2008

Claire Shaughnessy, of Rogerscasey, began her comments by providing a brief overview of the Connecticut Horizon Fund ("CHF") stating that it was established in September 2005 dedicated to investing in money managers that were emerging managers, minority owned, women owned, Connecticut based or utilized emerging strategies. She said that four fund-of-fund managers are part of the CHF program, Bivium Capital, Capital Prospects, FIS Group, and Progress Investment Management to manage investments that cover many of the traditional asset classes of the CRPTF.

Regarding the quarter ended September 2008, Ms. Shaughnessy reported that CHF's assets were \$693.9 million and the fund-of-fund managers employed 47 different money managers. She stated that the CHF underperformed its benchmark with returns down 8.68% lagging the hybrid benchmark by 134 bps for the quarter and also were down 17.33% for the one-year period lagging the benchmark by 37 bps net of all investment management fees. Ms. Shaughnessy reported that since inception the program returned a positive 2.26%, net of fees, or 28 bps above its hybrid benchmark.

Ms. Shaughnessy reported that there were three new CHF sub managers added during fiscal year 2008 to date. She then discussed the asset allocation and performance of the individual fund-of-fund managers as of September 30, 2008. Ms. Shaughnessy ended her comments by stating that the fund-of-funds were meeting the diversity goals, and that the breakout remained virtually unchanged since the prior quarter.

In response to an IAC member's question, Ms. Shaughnessy stated that no money manager had graduated from the CHF to date, but reiterated that Treasurer Nappier had awarded Ambassador preferred vendor status for the LF subject to successful contract negotiations. In response to other questions posed by IAC members, Ms. Shaughnessy discussed guidelines, concentration risks for funds and the referral process. Treasurer Nappier commented that graduation of sub-managers by the fund-of-fund managers would open new spaces for more emerging managers and emerging strategies. Discussion also ensued about the qualifying criteria into the CHF program and Treasurer Nappier stated that regardless of meeting the criteria of the CHF program if the due diligence performed by the fund-of-fund managers found a money manager to be inadequate, that firm would not be selected.

Private Investment Fund Review as of June 30, 2008

Bradley Atkins, Chief Executive Officer of Franklin Park, began by providing an analysis of private equity returns during prior recessions. He discussed the effects of a financial crisis on top quartile buyout firms and noted that these firms had historically posted internal rates of return averaging 20% since 1989. Mr. Atkins then reported that top quartile private equity firms did outperform public equities on a vintage year basis and added that top quartile managers performed best directly after economic recessions. He then commented on the secondary private equity opportunities in today's market, noting that secondary funds purchased at a deep discount should be compared to new opportunities in the market that have been revalued by market forces. IAC members posed questions about the current economic circumstances and how they related to private equity to which Mr. Atkins reiterated the importance of maintaining the CRPTF's long-term strategy and the significance of vintage year investments. He further noted that while it was important to understand market cycles, picking top quartile managers was an important criteria, which would allow for strong performance during the difficult economic cycles.

Finally, Mr. Atkins reported on the Private Investment Fund ("PIF") for the quarter ended June 30, 2008 by providing a portfolio overview. In summarizing performance, he noted that the return on the 70 investment commitments was \$5.8 billion in committed capital with \$4.3 billion drawn and \$4.2 billion returned back to the CRPTF and \$1.7 billion in value remaining,

demonstrating a return on investment of 1.3 times and 8.7% net return after fees and expenses. He noted that PIF outperformed the public market benchmark by 80 bps. Mr. Atkins then provided information on PIF's cash flow for the quarter ended June 30, 2008. He continued that during the third quarter of 2008 there was only a 2% market value impairment and there would likely be a markdown in the portfolio in the December 2008 report.

Combined Investment Funds Review as of September 30, 2008

Joseph Barcic, Principal and Makaiya Brown, Senior Associate of Mercer, provided the overall investment results for the Combined Investment Funds ("CIF") for the quarter ended September 30, 2008. Ms. Brown then reported on the overall investment results for the CIF for the quarter ended September 30, 2008. She reported that U.S. stocks fell across all market caps and investment styles. She continued that energy and utilities securities performed the worst during the quarter. Ms. Brown stated that, in general, value outperformed growth, small cap outperformed large cap and the CRPTF's performance was consistent with the markets. Regarding the Developed Markets International Stock Fund, Ms. Brown stated that U.S. markets outperformed non-U.S. equities and that the appreciation of the U.S. dollar further detracted from absolute performance for the most part; however, the 50% currency hedge helped to limit the losses, saving about 4% or roughly \$1.6 million.

Short-Term Investment Fund Review as of September 30, 2008

Lawrence Wilson, Assistant Treasurer-Cash Management, reported on the performance of the Short-Term Investment Fund ("STIF") for the quarter ended September 30, 2008. He stated that the STIF earned an average annualized yield of 2.30%, which was three bps below the benchmark. Consistent with the past several months, he cited that the lower performance resulted from a more cautious investment strategy where the focus was on high levels of liquidity, a shorter average portfolio maturity and restrictions in the types of investments securities purchased. As of December 5, 2008, Mr. Wilson stated that the STIF held about \$2.4 billion or 61% of fund assets in securities available on a same day basis, with a weighted average maturity of 19 days. He added that during the quarter, the Cheyne Finance notes were restructured effective July 23, 2008 and the position was converted into a security named Gryphon Funding notes. Mr. Wilson further stated that these securities were valued at a recovery rate of 76% with current reserves allowing for the reduction in value to be covered without any impact on the STIF's net asset value per share or any loss of principal to the investors. He said that the available reserves as of November 30, 2008 were \$31 million. Mr. Wilson stated that in early November 2008, Standard & Poor's formally reaffirmed STIF's AAAM credit rating.

In response to an IAC member's question, Mr. Wilson stated that the money in STIF's reserves is built up at an annual rate of 10 bps until 1% of assets had been reached.

Comments by David Roth

Mr. Roth cited an article regarding the Pennsylvania Pension Fund and its issues with portable

alpha and hedge funds. He stated that there was a need to understand the pit falls of hedge funds and felt this article would be helpful.

Other Business

Mr. Roth invited IAC members to submit agenda items for the January 14, 2009 meeting.

There being no further business, the meeting was adjourned at 11:26 a.m.

An audio tape of this meeting was recorded.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'H. Rifkin', with a long horizontal line extending to the right.

**HOWARD G. RIFKIN, DEPUTY TREASURER
for
DENISE L. NAPPIER, SECRETARY**

Reviewed by David Roth without modification.

I concur with Mr. Roth's review,

A handwritten signature in black ink, appearing to read 'J. T. Larkin', written in a cursive style.

**JAMES T. LARKIN
CHAIRMAN**