BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
SEPTEMBER 26, 2013

MEETING MINUTES

There being a quorum, Rob Dubow, Finance Director, Board Chairman, called the Investment Committee Meeting to order at 9:44 a.m., in the Board Conference Room, 2 Penn Center Plaza, 16th Floor.

Present:

Rob Dubow, Finance Director
Paula Weiss, Esquire, Deputy Director of Finance
Alan Butkovitz, Esquire, City Controller
James Leonard, Esquire, Chief Deputy City Solicitor
Brian Albert, Deputy Human Resources Director
Celia O'Leary, Deputy Director of Human Resources
Carol G. Stukes-Baylor, Employee Trustee
Ronald Stagliano, Employee Trustee
Andrew P. Thomas, Employee Trustee
Veronica M. Pankey, Employee Trustee
Folasade A. Olanipekun-Lewis, City Council Designee

Francis X. Bielli, Esquire, Executive Director
Mark J. Murphy, Deputy Executive Director
Sumit Handa, Esquire, Chief Investment Officer
Brad Woolworth, Deputy Chief Investment Officer
Christopher DiFusco, Esquire, Director of Investments
John Foulkes, Esquire, Investment Officer
Dominique A. Cherry, Investment Officer
Daniel Falkowski, Investment Officer

Also Attending:

Harvey Rice, Esquire, Alternate, First Deputy City Controller
Ellen Berkowitz, Esquire, Deputy City Solicitor
Katherine Mastrobuoni, Esquire, Assistant City Solicitor
Jo Rosenberger-Altman, Esquire, Divisional Deputy City Solicitor
Daina Stanford, Administrative Assistant
Carmen Heyward, Clerk-Stenographer II
Robert O'Donnell, Esquire, O'Donnell Associates
Charles Jones, Executive Director, Sinking Fund Commission
Jacob Walthour, Cliffwater
Keith Graham, Advent Capital Management, LLC

Will Greene, Loop Capital
Pam McCue, Financial Investment News
Michael Banks, Greentree
Joseph DiStefano, Philadelphia Inquirer

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Agenda Item #1 – Approval of Minutes of August 21, 2013

Mr. Dubow opened the meeting and requested a motion to approve the August 21, 2013 Minutes.

Mr. Handa requested that the motion be tabled to allow further edits for the minutes.

Mr. Dubow requested a motion to table the minutes. Mr. Stagliano made the motion to table. Ms. O'Leary seconded. All were in favor. The motion passed.

Agenda Item #2 – Advent Capital Management Update

Mr. Handa summarized Advent Capital Management's letter that addressed the Board's inquiry into the article in the *New York Times* published at the end of August about Advent's activities with the New York City Retirement System.

The article had inferred that there may have been an inappropriate relationship between Advent and the former New York City Comptroller, who was running for Mayor of New York City at the time of the article's publication

Mr. Handa summarized Advent's response that all interactions with the former New York City Comptroller were completely legitimate and in accordance with all New York City regulations. There was no pay to play issue as all investments were vetted by the New York City Retirement System's independent advisors and the investment has demonstrated good performance. Due to Advent's good performance, additional capital has been allocated by the New York City Retirement System under a new City Comptroller. The Board has been invested with Advent since September of 2009.

Agenda Item #3 – Flash Report for the Period Ended August 2013

Mr. Handa recalled Mr. Bielli's mention of *P&I's* article published, September 25, 2013, which compared returns for the City's Pension Plan in fiscal year 2013 to other plans. He noted the City's Pension Plan return of 12.08%, as compared to NCPERS, at 7.96%, Texas School System, at 4.5%, Harvard Endowment at 11.3% and Stanford University at 12.1%.

Mr. Walthour indicated that the August volatility in capital markets emphasized the value of the Board having portfolio diversification along with alternative investments in the portfolio. The broad market, as indicated by the S&P, was down about 2.34%, while the Pension Plan was down less than 1%.

He noted that one factor related to market volatility was the response to the Federal Reserve Bank's potential tapering in buying public securities. The Federal Reserve did not go through with the tapering in September, which led to a relief rally.

Mr. Dubow asked Mr. Walthour if something similar could occur in December, should the Federal Reserve make an announcement related to tapering. Mr. Walthour answered that the data was mixed, and as long as the data was mixed, the response would be muted.

Mr. Walthour reported on the market indices for August indicating that the S&P was down 2.90% and the International Developed markets were down 1.31%. The High Yield index was down 0.61% and the Barclays Aggregate index was down -0.51%. Compared to September, which was showing a better start as of today, the S&P was up 3.8%, International markets were up 8%, High Yield markets were up 1.8% and the Barclay's Aggregate was up 1%. The Fund gained more than was lost in the month of August. REITS recovered and were up roughly, 4% month-to- date.

Looking at the overall performance of the portfolio, the Fund was down 15 basis points relative to the index. The Total Fund was down 1.01% and the benchmark was down 0.85%. The relative underperformance was due primarily to the Fixed Income portion of the portfolio, both the Investment Grade and Opportunistic Fixed Income portion.

Mr. Walthour highlighted the positive contributions in the Alternatives space from 400 Capital, Apollo and Beach Point. They generated non-correlated performance and positive returns for the Fund during a difficult month. To Mr. Dubow's point, it was Cliffwater's thought that at some point the Federal Reserve Bank would taper, and these managers would be expected to deliver similar performance should interest rates increase.

Mr. Walthour reported that the August Flash Report was showing that all U.S. managers outperformed their indices for the month. Both Opportunity fund managers outperformed their indices. All International Equity managers underperformed their indices for the month and the Investment Grade Fixed Income managers underperformed their benchmarks as well. The Emerging Markets Managers continued to drag down the overall Fund performance. Real Assets, REITS and MLP's underperformed.

Mr. Walthour informed the Board that progress was made over the course of the year in moving toward the asset allocation targets.. Staff's decision to slowly move towards the asset allocation target was an excellent decision, with the single largest overweight in the overall Fund being the allocation to U.S. Equities, which has been the best performing asset class, excluding MLP's, in the portfolio.

The Absolute Return portfolio produced 24 basis points of excess return and a positive result during a down month.

Manager underperformance was primarily in the International Equity space. The Non-U.S. Equity Emerging outperformed its benchmark. In highlighting ESG's performance, the MSCI Emerging Markets Gross index was down 5.29% for the month, and for the trailing three months, it has been down 13.51% and, for the fiscal year, the index has been down 11.27%. Contrasting that with the performance of ESG, the emerging markets focused hedge fund, where the manager has the ability to go both long and short, the performance was positive for the month, positive for the trailing three months, and positive for the fiscal year. ESG since inception is almost 1,700 basis points above the benchmark.

Turning to the Opportunistic Fixed Income component, as the high yield market sold off, over the course of the month, the benchmark was down 81 basis points and over the three months and fiscal year, was down close to 4.0% and 3.5%, respectively. Beach Point, the credit focused hedge fund, actually generated positive returns, and since inception was up almost 400 basis points above the benchmark.

The overall Hedge Fund portfolio was up 59 basis points, generating 24 basis points of excess return. Seven out of the 11 managers outperformed for the month. Nine out of the eleven Hedge Funds outperformed their benchmark since inception.

The Independence Fund had a very good month in preserving capital and generating positive performance. The Independence Fund is the largest position within the Absolute Return portfolio, generated 20 basis points of positive performance, when the market was down approximately 2.9%. Since inception, the fund was up 9.87% versus the index of 6.5%, generating 3.3% of outperformance.

He noted that the Independence Fund was operating at a quarter to one-third of the volatility of the overall market.

Mr. Bielli asked if the positive references Mr. Walthour made to the Hedge Funds held true for September. Mr. Handa said that Hedge Funds did well in September despite the bull market; the S&P was up 4%.

Mr. Bielli asked Mr. Walthour to talk more about Apollo and KKR. Mr. Walthour reported that Apollo, a fixed Income credit-oriented manager, generated a positive return of over 1% in a negative return environment. Over three months, they generated 66 basis points of performance when the market was down 50 basis points. They are generating 1% of Alpha relative to their benchmark. Mr. Handa stated that Apollo was about 40% invested as of last week.

Mr. Walthour continued that KKR also did phenomenally well. They are benchmarked relative to the actuarial rate. He considered them to be a fixed-income, credited-oriented manager, and the 50% high yield, 50% leveraged loan benchmark applied to them as well. They were delivering 2.5% above the actuarial rate of return.

Mr. Handa reminded the Board that KKR'S numbers did not include the direct lending portion of their performance because reporting is on a lagged basis. If it was contributed, Staff's estimates that performance would be over 11.5%

Mrs. Stukes-Baylor asked Mr. Walthour to talk about Kynikos since inception.

Mr. Walthour said that they were short specialists, meaning that they sought out securities that they believe would depreciate in value, at which point Kynikos would generate a profit. Goldman Sach's statistical report indicated that of the 100 most heavily shorted stocks in the U.S. market, on average, those stocks were up 33%. The manager had been in an environment where the Equity markets were strong and operating as a massive headwind to short stocks. As the markets were stretched from a valuation perspective and were more likely to exhibit downside, he would not advise cutting them at this stage. If the market went down, they should generate positive return for the portfolio.

Mr. Dubow asked why Kynikos did not outperform in August. Mr. Handa informed that he spoke with Mr. Chanos during that time. Part of their short portfolio was short China. While the rest of the world underperformed significantly, about 14% of the Kynikos book was China. It was a China short with no long position to pair against it. The Chinese market rallied in August, and that was why performance was anemic in August.

Mrs. Stukes-Baylor asked Mr. Walthour, with this Quarter ending, and considering when Kynikos was funded, with December being another Quarter, how long should the Board wait before taking action on the manager. She looked since inception, and Kynikos has not performed.

Mr. Walthour said that Cliffwater would look at the asset allocation again. They were supposed to look at it on a one-year basis. Cliffwater's view was that they were hired to make money when the market went down, but the market went up dramatically. There was one month when the market was down, and they did not produce positive results.
It was his thought to give it a sustained time period when the markets were going down. It was Cliffwater's thought that it was a strategic decision to have them in the portfolio, and he did not advise thinking about cutting them at this stage, despite looking at their prior numbers. They were hired to perform in a specific environment for them to demonstrate how capable they are in doing what they do. The benchmark was also down.

Mrs. Stukes-Baylor said that the Board had benefits to pay, and she did not expect to see the same results next year. Mr. Walthour said they had not dramatically underperformed relative to their index. It was really the Board's decision to put Kynikos in as a measure of protection for the portfolio, essentially an insurance policy should the markets decline. The manager, so far, had done what they were supposed to do relative to their index.

Mr. Handa reminded the Board that Karsh Capital shut down in August, and the $22.5 million would be received in the next 30 days. Staff and Cliffwater started a process to present the Board with a replacement within six months time.

Mr. Walthour indicated that Karsch did not cease operations due to operational or other risk issues. The firm was marginally performing relative to other long/short equity managers and they decided that after 25 years of investing, they wanted to take a break. It was his thought that they would likely see Michael Karsch again in some format in the future

Agenda Item #4 – Flash Reports for the Opportunity Fund Managers for the Period ended August 2013

Ms. Cherry reported that both Opportunity Fund managers outperformed their respective targets for the month.

For PFM, most of the outperformance was on the Domestic Equity side. She referenced Cliffwater's comments about the possibility of a fed tapering having a negative impact on interest rate sensitive securities. She noted that Mar Vista was showing the worst performance, as a result of investing in high- dividend paying stocks which underperformed in the quarter.

For FIS, there were two non-US managers that stood out, Thomas White and Victoria. For Thomas White, stock selection in financials and health care accounted for 60% of their relative underperformance. Victoria's story was similar, where selection across their portfolio was negative.

Ms. Cherry updated that since the last Board meeting, Staff had met with all of the submanagers in the Opportunity Fund, with the exception of two or three. An RFP was issued for Domestic Equity Diversity, Emerging, and Local managers on Tuesday and RFP's for Fixed Income and International Equity would be issued in the upcoming months.

Agenda Item #5 – Second Quarter Directed Commissions Report

Mr. Falkowski reported on the Local Minority Brokerage Program. The Fund's Equity and MLP managers directed 28% of their trades to the Fund's approved women and minority brokers for the quarter, and 29% year-to-date.

For the Commission Recapture Program, the Fund recaptured just under $47,000.00 for the quarter, which represented an increase of 76% from the previous quarter.

The Fund's Equity managers directed 31% of their trades to the commission recapture brokers and 26% year-to-date.

Agenda Item #6 – Chief Investment Officer's Report

Mr. Handa reported that year-to-date Securities Lending income was $1.7 million at the end of August. The Fund's partnership with JP Morgan had done well, as reflected in the report.

He reported that the legacy collateral investments from State Street known as "Quality D" was valued at negative $2.1 million a year and a half ago, and today was valued at a little under $540,000. Staff has been working closely with JP Morgan to find ways to continue to improve the Quality D portfolio valuation.

Mr. Handa provided the report for the Local/Suburbs and Diversity Managers. Mr. Dubow confirmed that the Fund currently had approximately 25% of the Plan's assets invested with Diversity and Local Managers, up from a total of approximately 22% from last Quarter. Mr. Handa said that was correct.

He highlighted the memorandum in the Board packets related to the Independence Fund.

Mr. Handa requested Board approval to speak at the Global ARC Boston Investor Conferences from October 28th to the 30th, 2013. The nature of the conference would be about Alternative investments with Mr. Handa's panel discussion having a focus on manager economics.

Mr. Dubow requested a motion. Mr. Stagliano made the motion. Mr. Albert seconded. The motion passed.

Mr. Handa provided the Board calendars, highlighting the next Board Meeting for October 24, 2013. Mrs. Stukes-Baylor advised that she would be attending NAFTA's New York Conference for the October 23rd to the 25th, and the following week was not good, as well.

The Board Meeting for October was changed to November 7, 2013. Mr. Stagliano advised that the October Legislative Subcommittee meeting would need to be changed. Mr. Handa confirmed that the November Board meeting date would be changed to December 5, 2013, due to the Thanksgiving holiday.

At 10:53 a.m., Mr. Dubow requested a motion to adjourn the Investment Committee Meeting. Mr. Stagliano made the motion. Mr. Albert seconded. The motion passed.

At 10:53 a.m., Mr. Dubow called into session the full Board of Pensions and Retirement to ratify all actions taken at both the Deferred Compensation and the Investment Committee Meetings. Mr. Stagliano made the motion. Mr. Albert seconded. The motion passed.

At 10:53 a.m., Mr. Dubow requested a motion to adjourn the Board of Pensions and Retirement Meeting. Mr. Stagliano made the motion. Mr. Albert seconded. The motion passed.

The Investment Committee of the Board of Pensions and Retirement approved the Minutes on ____ .

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Rob Dubow, Finance Director
Board Chair