THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
DECEMBER 5, 2013

MEETING MINUTES

There bring a quorum, Paula Weiss, Esquire, Alternate Board Chair, called the Investment Committee Meeting to order at 9:30 a.m., in the Board Conference Room, 2 Penn Center Plaza, 16th Floor

Present:

Rob Dubow, Finance Director,
Paula Weiss, Esquire, Alternate, Deputy Director of Finance
Alan Butkovitz, Esquire, City Controller
James Leonard, Esquire, Alternate, Chief Deputy City Solicitor
Albert D’Attilio, Director of Human Resources
Brian Albert, Alternate, Deputy Human Resources Director
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
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
Jo Rosenberger-Altman, Esquire, Divisional Deputy City Solicitor
Katherine Mastrobuoni, Esquire, Assistant City Solicitor
Daina Stanford, Administrative Assistant
Donna Darby, Clerk Stenographer II
Carmen Heyward, Clerk Stenographer II
Robert O’Donnell, O’Donnell Associates
Stephen Nesbitt, Cliffwater
Jacob Walthour, Cliffwater
Clifton S. Robbins, Blue Harbour
Joseph Haslip, Blue Harbour

Denise Vellutato, FIS
Keith Graham, Advent Capital Management JoJo James, Public (Visitor)
Will Greene, Loop Capital

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Agenda Item #1 – Approval of the Minutes of November 7, 2013

Ms. Weiss opened the meeting and requested a motion to approve the minutes of November 7, 2013. Mr. Albert made the motion. Mr. Stagliano seconded. The motion passed.

Agenda Item #2 – Cliffwater- LLC- Update

Mr. Handa said that the article provided to the Board cited Cliffwater's receipt of remuneration for selected clients. He clarified that the article logo listed "Forbes" but that the site where it appeared was for non-staff bloggers. Forbes collected the information and posted it on their website.

When Staff received the article, they contacted Cliffwater immediately. Staff sent Cliffwater a list of questions, and those questions, along with the answers provided by Cliffwater, were in the Board packet.

Mr. Handa advised that Mr. Nesbitt and Mr. Walthour would address any Board questions about the article, the study, as well as any other issues.

Ms. Weiss asked if there were questions. Mrs. Stukes-Baylor said that she saw the information and performed her due diligence to make the Board aware that something was out there. Mr. Bielli asked Mr. Nesbitt to talk about Brown Brothers Harriman ("BBH"), and specifically the nature of Cliffwater's relationship with one of BBH's General Partners. Mr. Nesbitt said that Cliffwater was hired as an Alternative Consultant for the Rhode Island Pension Fund, working with Private Equity, Hedge Funds and Real Assets. They had a relationship with BBH, a private bank, with large, high net-worth clientele. BBH offers private equity to their investors. BBH hired Cliffwater to help them select and monitor their private equity managers. Cliffwater disclosed during the RFP process at Rhode Island that they had no business relationship with the pension plan's existing managers. Cliffwater was hired and subsequently, Rhode Island's other general partner did an RFP and recommended BBH for T.I.P.S. Cliffwater was not part of that selection process. They were not part of the approval process and did not make a recommendation to hire BBH.

Mr. Bielli asked Mr. Nesbitt if he brought BBH as an idea to the Rhode Island fund, provided recommendations, had comments or knew that they were investing. Mr. Nesbitt answered no.

Mr. Bielli asked Mr. Nesbitt if Cliffwater had relationships with the investment managers that were in the Board's [Philadelphia's] plan or if they had a financial interest in any of their parent companies, whether it be an insurance company, a bank or a mutual fund association. Mr. Nesbitt said Cliffwater had vetted everything, and the answer was no. Mr. Bielli asked if the answer was no even for the Board's legacy managers, those that Cliffwater had not originally recommended to the Trustees. Mr. Nesbitt answered, no.

Mr. Nesbitt identified business relationships with five registered investment advisers, loosely defined as being money managers, namely BBH, a Finish insurance company, an Australian Pension Plan, a Mid-West insurance company and two other insurance companies.

He said that it was a very remote possibility that Cliffwater would be in a position where they would be doing work for the Board that would intersect with any of those situations. Cliffwater's policy was that if they found such a situation, they would immediately let the Board know the nature of that relationship so that it would be fully disclosed. In the event that they did not have a business relationship, but there was even the appearance of conflict, they would disclose that to their clients.

Mr. Bielli asked Mr. Nesbitt who did all of the in-house vetting at Cliffwater. Mr. Nesbitt named Barbara Smith as Cliffwater's Chief Compliance Officer. She had been with them since inception, and he worked with her for 20 years.

Mrs. Stukes-Baylor recalled from the last Investment Committee Meeting, when staff disclosed a possible pay-to-play situation within investment relationships that appeared in the newspapers. She commented that these issues were related to questions posed to the International Union, where the article brought out that AFSCME hired an outside person to get the information because the Rhode Island Treasurer refused to provide information on hedge funds. It impacted the [Rhode Island's] members' pensions because the [Rhode Island] Treasurer was leading pension reform efforts. Mrs. Stukes-Baylor wanted to make sure that it was not happening at this Board table.

Mr. Bielli added to Mrs. Stukes-Baylor's comment that he discussed it yesterday with Mr. Stagliano, and with Mr. Handa. Mr. Bielli confirmed that Mrs. Stukes-Baylor's information was correct as it related to the Rhode Island Treasurer. A lot of the allegations in the Rhode Island report were that she was a Wall Street person who came to Rhode Island, and much of the business was going to former colleagues at the fee of two and twenty.

The Philadelphia Board of Pensions is no longer paying two and twenty with the new managers with which they have been negotiating. The fees have often been reduced to one and fifteen or less.

Mr. Bielli noted that there was another recent related article entitled "Wall Street's License to Steal", about New York's Pension Fund, and how that state's financial overseer was looking at the fees they were paying. Their fees were considerably higher year-over-year. The assets were going up, and so the fees went up. The Philadelphia Board of Pensions' assets went up, but the fees had not gone up. In fact, the fees are the lowest since 2008.

Mr. Bielli reminded the Board that it was incumbent upon them to do their due diligence and ask those types of questions because it is a Fund for 64,000 members.

Mr. Bielli thanked Mrs. Stukes-Baylor for bringing the issue to the Board's attention.

Agenda Item #3 – Blue Harbour Strategic Value Partners Offshore, Ltd.
Staff and Consultant Recommendation and Manager Presentation

Mr. Handa quoted activist Mohanda K. Ghandi's statement "be the change you want to see most in the world", as he was the ultimate activist that brought an empire to its knees.

Generally speaking, board composition and compensation were controlled primarily under state law. However, this shifted following the events of 2008 to shareholders taking a greater role and responsibility in making sure corporations were accountable and responsible to shareholders. It was the reason that staff and Cliffwater were recommending a $40.0 million investment in Blue Harbour Strategic Value Partners Offshore, Ltd ("Blue Harbour").

Mr. Handa identified Blue Harbour as an activist fund that the Board reviewed in the past. They were unique in their skill set in unlocking (pages 2 and 3) the value of undervalued securities. Staff's belief was that Blue Harbour could unlock value by using activism. Their approach involved discourse with the company boards to offer advice on spin-offs, sales of certain businesses, a potential sale of the company and buying back shares. He said that Clifton Robbins would present in more detail.

Mr. Handa said that Blue Harbour was also unique in the way that they focused on small to mid-cap companies, with AUM of between $500.0 million and $5.0 billion, rather than larger companies. Their companies were less efficient with less analyst coverage and ripe for activism. They managed about $1.7 billion, with 7% of the assets being held by insiders, who had over $100.0 million of their own capital invested in the fund.

Ms. Weiss asked Mr. Handa what class of shares staff was recommending. He said Class III. Staff's belief was that the strategy would do well for the next three to five years by having a private market value approach to public markets. There were lower management fees as well as performance fees that were paid after the three-year period, as opposed to on a year-to-year basis.

Ms. Weiss invited Mr. Robbins and Mr. Haslic to present.

Mr. Clifton Robbins, CEO and Portfolio Manager, presented, along with Mr. Joseph Haslic, who is Managing Director of Public Plan relations at Blue Harbour.

Mr. Haslic thanked the Board and Cliffwater for the work that they had done on behalf of the Plan and revealed that their goal was to provide a clear sense of Blue Harbour's strategy and help the Board to understand that they were a good portfolio fit. As an additive partner, they understood the work of the Board in supporting retirement security.

Mr. Haslic shared that Mr. Robbins founded Blue Harbour in 2004, and they currently were at $1.9 billion in AUM. He talked about Blue Harbour's collaborative approach to active ownership investing with companies in the small or mid-cap areas with between $1.0 billion to $5.0 billion market cap. Their strategy sought to become lead shareholders in the companies in which they invested through their core portfolio holdings. They held seven to ten names, and the net return, year-to-date, for the firm was 22%. Annualized over the past five years it was 16%, with half of the market volatility.

Mr. Robbins provided a brief overview of his 20-year background in the private equity investment world. After a ten-year career at Blue Harbour, he generated ideas about backing the right management teams and could avoid paying the 30% to 50% control premium by buying a minority stake in companies and working to unlock the value. The approach provided better liquidity, which they identified as a private equity approach to the public markets. He highlighted the fact that Blue Harbour had lost money only three times in nine years in a core stock position.

He provided more details about (pages 5-6) Blue Harbour's experienced team of senior investment partners. Their company had very low turnover. They met solely with the CEO's and the chairpersons of their portfolio companies because Blue Harbour's strategies were radical in changing capital structures, selling businesses that did not fit, buying back stock and selling the whole company.

Mr. Robbins highlighted (page 10) the sea change in the attitudes about corporate governance as a good tailwind to their strategy, related to large public institutions like CalPERS that made a $250 million investment with Blue Harbour. It represented a democratization of stockholder rights and a good shift towards important, permanent change.

Mr. Robbins talked about (page 12) being in the value-oriented space as a strategy that focused on companies that had high free cash flow yield within concentrated portfolios.

Ms. Weiss asked Mr. Robbins to talk about how they sourced their companies. He talked about their evolution from techniques in 2004- 2005 of screening for high, free cash flow yield and using computer techniques, to finding companies, to knowing the companies, and keeping relationships with their companies. They still did occasional screenings, but the best ideas came from companies that they knew.

Mr. Handa asked Mr. Robbins if they were sought out by disgruntled shareholders. He said that they were, and Blue Harbour was well networked with other managers in their small to mid-cap space that brought ideas to them. They did not partner with other hedge funds, but they did network with other long-only managers they respected and that knew the industries.

Mr. Robbins talked (page 14) about Blue Harbour's ideas and the nature of their portfolio strategies related to M&A and balance sheets, in helping companies reshape the businesses their companies owned, as well as redeploy their cash. Blue Harbour liked the $1.0 billion to $5.0 billion market capitalization companies because they did not have their own resources to come up with this type of idea. It afforded Blue Harbour an opportunity to come up with a unique idea to unlock value that would bring their stock up 30% to 50%.

Mr. Robbins responded to Board questions about their small cap focus, their strategy and specifics about their companies.

Mr. Robbins closed in touting their risk management and compliance procedures. He invited Board questions.

Ms. Weiss said that staff was recommending a $40.0 million investment in Class III Share for Blue Harbour Mr. Albert made the motion. Mrs. Stukes-Baylor seconded. Ms. Weiss requested a Board votes. All were in favor, except for Ms. Pankey, who abstained. The motion passed.

Mr. Handa recognized Katharine Mastrobuoni's work in negotiations, as well as everyone involved who negotiated with Blue Harbour. The Board also thanked Ms. Mastrobuoni.

Agenda Item #4- Flash Report for the Period Ended October 2013

Mr. Walthour advised that the quarterly report and the monthly report format would change from two reports to one.

He reported a positive month for all asset classes (page 2) through September 30, 2013, with the exception of REITS.

The total fund performance for the quarter was 4.91%, which was slightly below the policy benchmark. The issue during the quarter was the underperformance in most categories of active managers.

Due to the lag time in the report for private assets that contributed to the negative return Cliffwater would be working with JP Morgan to separate the liquid portion of the portfolio to get monthly information on the indices and calculate the non-liquid portion of the portfolio at a later date.

Mr. Walthour reported that the Fund was up calendar-year-to-date by almost, 9% versus the benchmark of 9.48% and through October, the portfolio, on a fiscal-year-to-date basis, was up 6.53% versus 7.32% for the index. Mr. Walthour walked the Board through the various asset classes and their recent performance.

Mr. Walthour noted the underperformers for the quarter were Stone Harbour and JP Morgan, the Emerging Market Bond ETF.

Mrs. Stukes-Baylor talked with Mr. Walthour and Mr. Handa about managers that underperformed, asking if it warranted Board action. She asked if they considered Kynikos to be at a high underperformance rate. Mr. Walthour reminded that the manager was a hedge for the equity portfolio, to protect the portfolio from market risk. Reducing them or terminating them would be to say that they would no longer need the hedge. His suggestion was not to think about reducing or terminating at this point.

Mrs. Stukes-Baylor asked Mr. Walthour how long was the Board supposed to look at their negative performance. Mr. Handa provided a historical update on Kynikos's performance, as well as a brief explanation as to why staff recommended them.

Mrs. Stukes-Baylor said that she would bring the topic up again next month.

Agenda Item #5 – Flash Reports for the Opportunity Fund Managers for the Period Ended October 2013

Mr. Dubow entered the meeting.

Ms. Cherry reported for the month of October, both Opportunity Fund managers slightly underperformed their targets, FIS by -10 basis points and PFM by -25 basis points.

For FIS Domestic Equity, one manager in particular was the main detractor from their performance: CUPPS All Cap Growth. The strategy underperformed by 400 basis points against the Russell 3000. The main detractor was their underweight to consumer staples and telecommunications. Those sectors did well for the month, and that affected CUPPS.

For PFM, Philadelphia Trust underperformed for the same reasons. In addition, there was one position for Philadelphia Trust, Taradata, which was down 10%, and that detracted from their relative performance. For Profit Investment Management, three of their technology holdings detracted over 100 basis points from their relative performance.

Mr. Handa updated that staff and Cliffwater were conducting Equity searches and hoped to have a Subcommittee meeting in January. The fixed income RFP closed last week, and staff received 28 responses. The International RFP was going out on or about December 13, 2013.

For February, staff and Cliffwater were currently performing due diligence on three alternative managers and hoped to have one of them present before the Board at the February meeting.

<u>Agenda Item #6 – Herndon Capital Management – Transition Recommendation</u>

Ms. Cherry informed the Board about Staff being advised via a recent telephone conversation that FIS exited their Herndon international position in all of their other client accounts. As a result, staff requested a recommendation and memo from FIS regarding the City of Philadelphia account. After review of their memo and recommendation, Staff recommended a transition out the Herndon international account in the FIS portfolio and into Causeway.

As of the end of September, Causeway was up approximately 23% since inception. As noted earlier by Cliffwater, Causeway had been one of the top contributors in the portfolio. As of October, calendar-year-to-date, Causeway was up about 22.5%. As of the end of September, there was approximately $9.2 million in the Herndon portfolio.

Mr. Dubow asked if they were international or the same category. Ms. Cherry said that Causeway was benchmarked against the EAFE, and Herndon was benchmarked against the ACWI.

Mrs. Stukes-Baylor asked if the Board was going through a RFP process, why were changes being contemplated now. Mr. Handa said that FIS did not want to have exposure to Herndon, and staff agreed with that conclusion. In going through the transition, staff believed that Causeway was a good place to invest the dollars, rather than the two managers that FIS recommended, Thomas White and WCM, respectively. Additionally, Causeway is a women-owned fund, while the two firms recommended by FIS are neither diversity nor local firms. Causeway's performance was superior to the two managers that FIS recommended.

Mr. Handa said that staff was recommending that [approximately] $9.0 million be allocated to Causeway.

Mrs. Stukes-Baylor asked Mr. Handa if the money would go back to the manager the Board hired during the RFP.

Mr. Bielli said that Mrs. Stukes-Baylor's concern was if the Board was taking $9.0 million away from the Opportunity Fund managers to give to the Non-Opportunity Fund managers, which was technically true. FIS's proposal was to give the money to non-women and non-minority managers, but the Board wanted to give the money to a women-owned firm. Mr. Handa added that they were one of the best performers since inception.

Mrs. Stukes-Baylor questioned if this proposal would impact the asset allocation matter later in the agenda.

Mrs. Stukes-Baylor added that she was not in favor of the proposal simply because Causeway was women-owned. She wanted to be fair. She recalled that the Board agreed that when they created the Opportunity Fund, the managers that were doing well should have a place in the full fund.

Mrs. Stukes-Baylor again questioned the timing of the proposal given the outstanding RFP's for emerging, local and diversity managers.

Mr. Handa responded that it did not detract from the asset allocation. It was staff's observation that this was the best alternative source of generating superior returns for the portfolio. The Board was meeting their social responsibilities by giving the allocation to a women-owned fund. It was his thought that the Board had been pleased with Causeway's performance. The manager was up 22%-23% for two years. Their strategy was sound and in an area in which the Board wanted to be invested. The Board alternatively, could choose to put the money to an index fund. Staff did not believe that it should be going with the two managers that FIS recommended because they were not doing well.

Mrs. Stukes-Baylor stated that the Board was transitioning from FIS and PFM and questioned why the Board was seeking a recommendation from them.

Ms. Cherry said that staff requested more details with respect to the memorandum from FIS on why they exited the position in other client accounts and why staff was not aware of that.

Mrs. Stukes-Baylor recalled that FIS formerly tried to change their position on how they managed the international sector. At that time, she blocked the proposal because she was concerned about not including more minorities. FIS provided the Board with a memo about going into another direction and terminating Herndon. Mr. Walthour confirmed his recollection that it was when FIS presented an international equity proposal in the early part of 2013. He did not remember the managers that they were recommending to terminate or add. He did remember that they proposed to move the account towards international.

Mr. Dubow asked Mr. Handa for Staff's recommendation. Mr. Handa repeated the recommendation.

Mr. Walthour said that it was better not to move the money twice and absorb transaction costs. If a manager was being terminated to provide cash, it was better to deposit the cash into a place for an extended period of time.

Mr. Stagliano considered Mrs. Stukes-Baylor's statement about where the money would come to give to the new managers. Mr. Stagliano pointed out that not all of the current managers would survive the RFP process, and as such, there would be money available to fund the selected managers.

Mr. Handa said that Mr. Stagliano's comment was correct and there was ample dollars to fund the RFP.

Mr. Dubow requested a motion. Mr. Albert made the motion to transition the assets from Herndon to Causeway. Mr. Stagliano seconded. Mr. Dubow requested a Board vote. The motion passed.

Ms. Pankey asked since Herndon was also in the same space with PFM, was the Board taking action to transition them out of PFM.

Mr. Bielli suggested that staff's role as it related to the Opportunity Fund be clarified and that the first part of it was a non-issue because the Board said that staff would determine what moves to make with the Opportunity Fund. However, the second part was where to put the money until the RFP was done He said that the Board needed a recommendation to subsequently invest whatever they decided to be moved.

Mr. Dubow asked Mr. Handa for the amount with PFM. Mr. Handa said that Herndon had about $17.0 million.

Mr. Dubow requested staff's recommendation. Mr. Handa said that staff's recommendation was that they move all of the money from PFM and FIS from Herndon's international position to Causeway.

Ms. Pankey asked Mr. Handa for the total amount to be allocated to Causeway. Mr. Handa said about $27.0 million.

Mr. Dubow requested a motion. Mr. Stagliano made the motion. He added to the motion that staff take whatever action that they would need regarding the Opportunity Fund between now and the end of the transition period and report to the Board about their actions. Mr. Albert seconded. Mr. Dubow requested a Board vote. Mrs. Stukes-Baylor was opposed. Ms. Pankey abstained. The motion passed.

Mrs. Stukes-Baylor confirmed that Mr. Stagliano's motion was that staff should provide the Board with a report of their actions.

Mr. Handa said that in January the Subcommittee would meet and based on their conclusions make recommendations to the full Board in February. Mr. Handa said that domestic equity would be first, then fixed income, and finally International.

Mrs. Stukes-Baylor said that staff was overseeing the management of money as a consultant would. She was requesting that they divulge where they would put the money before she sees a report. She was requesting that staff tell the Board before they transitioned the money.

Mr. Butkovitz said that it was a special case and a relatively small amount of money, an effort to avoid transaction fees, and he did not see it as a precedent setting event.

Mrs. Stukes-Baylor referred to Ms. Pankey's asking if the Board was terminating PFM's allocation with Herndon. She asked if it had not been brought to the table, would it have been mentioned. She considered this to be a matter of due diligence. So, her request was that staff bring their suggestions to the Board. Her position on the motion was that it should not be approved.

Agenda Item #7 – Asset Allocation Recommendation

Mr. Nesbitt said that Cliffwater's first recommendation was that there be no change to the asset allocation policy adopted in 2012. Cliffwater's estimation was that the policy portfolio would produce an expected rate of return, net of fees, of 7.96%.

Mr. Dubow asked Mr. Nesbitt what were Cliffwater's underlying assumptions, in terms of what would happen with the economy and the market, and how he arrived at 7.96% Mr. Nesbitt referred to (page 1) expected returns on the individual asset classes as of October 1, 2013. Mr. Dubow noted that the underlying assumption would be a slowdown from what was happening this year, and Mr. Nesbitt added a slowdown in terms of returns. Mr. Dubow asked him if Cliffwater's model was considering a slowdown in the markets in general. Mr. Nesbitt reported last year U.S. stocks went up 30%, and Non-U.S. stocks went up 20%. Cliffwater considered this abnormal. He cited the QE3 activity of government central banks purchasing securities and driving up asset values.

Mr. Dubow noted that the returns were better than Cliffwater's model would have shown. He asked if the same kind of government activity started the next year, would the model be the same. Mr. Nesbitt said that it might, but it was less likely because V/E ratios had been more elevated and yields had dropped. The expectations were more normal.

He said that the 7.96% was a combination of the Fund's policy weightings to the individual asset classes multiplied by Cliffwater's expected returns for those asset classes. Cliffwater's report would later reveal that their expected returns would be a little lower than their presentation one year ago.

Mr. Dubow noted Cliffwater's recommendation for fixed income investment grade; the Fund was at 14%, and they were recommending going down to 6%. Mr. Dubow asked about the 6% and questioned why it would not be even lower than that. Mr. Nesbitt said that Cliffwater recommended 6% one year ago, and the Fund had not gotten down to that. It was an issue of Cliffwater not only looking at the returns, but at the liquidity of the portfolio overall. Historically, the Fund had been negative cash flow.

Mr. Nesbitt said the Board asked Cliffwater to make investment recommendations on individual managers.

Mr. Nesbitt said that the key to Cliffwater's presentation today versus one year ago was to get the current allocation closer to the policy allocation.

Mr. Nesbitt presented (page 3) side-by-side analysis of the allocation as of September 30, 2012, with an update for 2012 to 2013's expected policy return. He reported that the portfolio did well and performed above expectation from 2012, producing a trailing one year portfolio return of 14%. In some cases, success led to lower expectations going forward, and the recommendation that Cliffwater gave the Board one year ago produced not an 8.1% expected return, but 7.96%. Cliffwater had lowered their expectations slightly for stocks. Cliffwater's expectation was currently 7.2% for stocks. At the last asset allocation, it was 7.55%. There would be ups and downs in terms of return expectations, but in terms of the calculus related to the Fund's actuarial return assumption, they were in the zone.

He said that the key today from one year ago was getting the current allocation closer to the policy allocation. There were still differences that Cliffwater would like to see closed over time. He noted how Mr. Handa did a good job in building a platform for the non-investment grade fixed income to move assets into it.

Mr. Dubow asked how long it would take to get closer to the policy. Mr. Nesbitt said with most of the asset classes, six to twelve months. Mr. Handa projected the completion date to be within the next three to six months.

Mr. Bielli asked in what areas Cliffwater recommended staff focus to bring the Board closer to the policy allocation. Mr. Nesbitt suggested that the Board could multi-task. The opportunity in the non-investment grade fixed income could move rapidly now that the pieces were in place. The challenge would be in the private assets area, whether it was equity or debt. They took more time.

Mr. Bielli (page 5) asked Mr. Nesbitt why the total recommended equity allocation was 44% on page five and on page three it was 40%. Mr. Nesbitt said that Cliffwater wanted to get it down to 40%. The private equity debt (page 7) policy was 17%. Mr. Walthour added that it was not until after the capital was called that the money actually went into these funds.

Mr. Nesbitt provided a recommendation to terminate Barings International. Mr. Walthour reported that on a one-year basis, Barings was 11% behind the benchmark.

Mr. Nesbitt said most of the money was recommended to be added as an allocation to Northern Trust Investments.

Mr. Nesbitt presented ways to get closer to the policy return by terminating some managers and reallocating the assets.

The first of the other two recommendations was a move to break out the Independence Fund within the absolute return portfolio, to treat it as a Hedge Fund, but monitor the outside hedge fund managers as separate from the internal account. This would be done to get a composite of the external hedge fund managers. The internal account was different, large and could dominate the overall performance.

The second (pages 4-7) recommendation was to increase allocations to the three MLP managers and increase allocations to the REIT managers to get the policy closer to target.

Mrs. Stukes-Baylor revisited Cliffwater's recommended allocation for private equity. Mr. Nesbitt said Cliffwater had not made recommendations for private equity and debt moving from the 11% to the 17% because it was for the Board's consultant in private equity and for staff to recommend how to get from 11% to 17%.

Mr. Dubow asked Mr. Nesbitt if he was recommending an increase over time to 17%. He said, yes, for private equity and debt. Mr. Dubow asked if it was the same six to 12 months. Mr. Handa said that it would be a one-year process.

Mr. Woolworth said staff could commit capital, but whether or not they could draw capital was the issue. Mr. Walthour added that they could find funds to invest in, but unless the fund(s) called the money from the Board, their allocation would still be lower than expected. They could talk about whether or not there were surrogates to get the exposure. Some funds used activists as a surrogate in private equity until they could get their total private equity allocation in place.

Mr. Dubow asked if the Board was voting on page three. Mr. Nesbitt said yes.

Mr. Nesbitt said that the manager excess return included alpha for hedge funds of about 3.5%, private equity managers to perform better, by about 3% more than what they would expect in publically traded stocks. Cliffwater was not factoring in alpha that domestic equities managers or international equity managers might produce.

Mr. Dubow asked Mr. Nesbitt if they were assuming that the return would be the same as if they were in an index fund. Mr. Dubow asked in which class was that true. Mr. Nesbitt said domestic equities, international equities, and for fixed income.

Mr. Bielli asked if the alpha Cliffwater attributed to the alternative managers was based on historical returns. Mr. Nesbitt said yes, experience, that was correct, based on what they had or had not produced for the Board.

Mr. Bielli said that the Board needed to address page two, because the asset allocation had not changed, but the Board needed to address the recommendations on specific managers (page 2).

Mr. Stagliano made the recommendation to accept all of the recommendations on page two of Cliffwater's report, except for Geneva.

Mr. Dubow said that the Board would be voting on the terminations, but not the recommendations on where the money would be going. Mr. Stagliano added that they would do that separately.

Ms. Pankey asked for clarification. Mr. Stagliano said he was making a recommendation to accept all of the recommendations on page two, except for Geneva.

Mr. Dubow said that they would be terminating Barings, Merganser and Stone Harbor. Mr. Stagliano said, correct, and leaving the small position in Geneva, the women-owned firm, until the subcommittee met.

Mr. Dubow said before they decided the terminations, where should the money be transferred. Mr. Bielli said that Mr. Nesbitt's recommendation (page 5) was to divest with Barings and put the money into a (page 5) a directed trust index. Mr. Walthour said that Merganser would be allocated to the high-yield opportunistic fixed income managers.

Mr. Dubow said that the recommendation was for Rhumbline, a $46.0 million increase, Northern Trust, a $128.0 million increase, and high-yield opportunistic fixed income was for KKR, Apollo, and Avenue.

Mr. Bielli asked Mr. Nesbitt if the Board could go with new managers for the recommendations. Mr. Nesbitt deferred to Mr. Handa.

Mr. Handa responded to questions about the changes, by saying that in February, staff would be recommending $60.0 million of new manager allocations. Staff and Cliffwater were completing due diligence. In March, two other managers would be coming as well. The additions to Apollo and Caspian were wise decisions, which represented approximately $80.0 million. Staff agreed with the termination of Barings, and they were in agreement with the move into an index fund while they found other alternatives.

Mr. Handa informed the Trustees that an Independence Fund memo for November was placed into the Board's binders that provided a lot of details. Part of the discussion included several strategies that staff would be recommending to the Board over the next year, including emerging market managers, long/short strategies on the debt and equity side, and revolving debt funds.

Mr. Bielli asked Mr. Handa if the timeline would be structured in a way so that the money would not be dormant prior to February. Mr. Handa said within the next three to four weeks they should be able to move all of the capital at issue.

Mr. Handa also noted Ms. Folasade Olanipekun-Lewis' recent memo and informed the Board that Staff received $64.0 million yesterday to pay benefits.

Mr. Dubow requested that Mr. Handa provide a memo that would display how the monies from terminated managers were being allocated. Mr. Handa responded that staff would provide a "Sources and Uses" memo that would be electronically mailed to the Board members within the next 24 hours so that everybody would understand the numbers. Staff could complete the entire process over the next four weeks or two months, whatever the Board preferred.

Mr. Dubow asked for a second to Mr. Stagliano's motion to terminate the managers, except for Geneva. Mr. Albert seconded. Mr. Dubow requested a Board vote. The motion passed.

Mr. Dubow requested a motion for part II, the reallocation of the money.

Mr. Walthour said that the definitive allocations were Apollo, Caspian, Harvest, FAMCO Tortoise, 400 Capital and Axonic in the amounts indicated in the column.

Ms. Pankey asked if the amounts would change because the Board was not going to vote for Geneva. Mr. Walthour said slightly.

Mr. Dubow requested a motion. Mr. Albert made the motion to increase the allocations to the managers as identified on page 4-6 of Cliffwater's report, with the change of the $14.0 million going to the index, instead of the $46.0 million.

Mr. Butkovitz seconded. Mr. Dubow requested a Board vote. Mrs. Stukes-Baylor & Ms. Pankey were opposed. There were no abstentions. The motion passed.

Mrs. Stukes-Baylor asked why there was disparity between the active managers, hedge fund and alternative managers. She noted that allocations were given to index managers that were doing poorly, but not to active managers. She also inquired as to the status of the watch list.

Ms. Weiss's noted Mrs. Stukes-Baylor's concern and question of whether or not the Board would consider additional allocations to managers that performed well.

Mr. Handa's said that the Watch List would be ready by January.

Mr. Dubow exited the meeting, and Ms. Weiss chaired through Agenda Item #8.

<u>Agenda Item #8 – Chief Investment Officer's Report</u>

Mr. Handa provided the Securities Lending report. It showed the benefits of the partnership with JP Morgan.

He said that the Quality "D" report was provided.

The breakout of local and diversity managers was provided in the report.

He provided the October & November performance for the Independence Fund. The audited numbers will be available in December.

Mr. Handa informed that he was invited to speak at a private equity panel, and that it would be in New York next Wednesday.

He said that the Board calendars were in the binders for January, February and March of 2014.

Mr. Stagliano requested a report from staff about the second installment of money received from the City of Philadelphia. He requested a page be included in the binders every month that provided the MMO and what was received to-date.

Mrs. Stukes-Baylor made a motion to attend the NCPERS Legislation Conference, January 26, 2014, through January 28, 2014, in Washington, D.C., for herself and for all members who wanted to attend. Mr. Stagliano seconded. The motion passed.

At 12:30 p.m., Ms. Weiss requested a motion to adjourn the Investment Committee Meeting. Mr. Albert made the motion. Mr. Stagliano seconded. The motion passed.

At 12:30 p.m., Ms. Weiss called into session the full Board of Pensions and Retirement and requested a motion to affirm all actions taken at both the Deferred Compensation and the Investment Committee Meetings. Mr. Rice made the motion. Mrs. Stukes-Baylor seconded. The motion passed.

<u>New Business</u>

Ms. Weiss invited Ms. Mastrobuoni to update the Board about the status of a court case related to deceased Philadelphia Police Officer, Michael Walker's spouse versus the City of Philadelphia. Ms. Mastrobuoni noted the case involved Michael Walker's estranged spouse [Rosemarie Walker] contesting his benefit that was awarded to his father instead of his wife and children. Ms. Walker fought the award for 18 years, arguing that it was not his [Michael Walker's] signature on the beneficiary form. Judge Tucker dismissed Mrs. Walker's complaint with prejudice. She cannot appeal the case further.

Mr. Leonard said that it was a significant win. The case went through the Board and through the Appellate Courts and the Court of Common Pleas for close to 20 years. He said that Ms. Mastrobuoni had a great argument, and Ellen Berkowitz assisted. It was a great win and a team effort.

At 12:30 p.m., Ms. Weiss requested a motion to adjourn the Board of Pensions and Retirement. 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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Paula Weiss, Esquire, Deputy Director of Finance
Alternate Board Chair