THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
MAY 24, 2012

MEETING MINUTES

There being a quorum, Paula Weiss, Alternate Board Chair, opened the Investment Committee Meeting at 9:32 a.m., 16th Floor Board Conference Room, Two Penn Center Plaza.

Present:

Rob Dubow, Finance Director
Paula Weiss, Esquire, Alternate Board Chair
Alan Butkovitz, Esquire, City Controller
Harvey Rice, Esquire, Alternate, First Deputy City Controller
Brian Albert, Alternate
James Leonard, Esquire, Alternate
Celia O'Leary, Alternate, Deputy Director of Human Resources
Ronald Stagliano, Employee Trustee
John A. Reilly, Employee Trustee
Carol G. Stukes, Employee Trustee
Veronica M. Pankey, Employee Trustee
Anne Kelly-King, Non-Voting Board Member

Executive Director:	Francis X. Bielli, Esquire
Deputy Executive Director:	Mark J. Murphy
Chief Investment Officer:	Sumit Handa, Esquire
Deputy Chief Investment Officer:	Rhonda McNavish
Investment Officer:	John Foulkes, Esquire
Investment Officer:	Brad Woolworth
Investment Associate:	Dominique A. Cherry
Investment Associate:	Daniel Falkowski

Also Attending:

Robert O'Donnell, O'Donnell Associates
Christopher DiFusco, Esquire, Divisional Deputy City Solicitor
Benjamin Hinerfeld, Esquire
Katherine Mastrobuoni, Esquire
Stephen Nesbitt, Cliffwater
Jacob Walthour, Cliffwater
Ashley Cooke, Cliffwater
Brad Atkins, Franklin Park
Raymond Jackson, Franklin Park
Steve Novick, Courtland Partners
Marc Rivitz, Courtland Partners

Scott Klein, Beach Point Capital Management
Zach Axelrod, Beach Point Capital Management
Andrew Thomas, Local #22, Firefighters
Donna Darby, Investments
Carmen Heyward, Investments
Will Greene – Loop Capital
Wayne Pollock, Visitor
Catherine Lucey, Philadelphia Daily News

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Agenda Item #1 – Approval of Minutes

Ms. Weiss called the meeting to order and requested a motion to approve the Minutes of April 26, 2012. **Mr. Reilly made the motion. Ms. O'Leary seconded. The motion passed.**

Agenda Item #2 – Beach Point Capital Management -Beach Point Offshore Total Return Fund II, Ltd.

Mr. Handa talked about Beach Point Offshore Total Return Fund II, providing a brief description of the hedge fund, with an overview of credit-market investing, their product, process, returns and the advantages and risks associated with the product.

Board discussion focused on various City laws, and/or legislation and the policy that they followed for screening firms in light of predatory credit lending practices.

The founding partners of Beach Point, Mr. Klein and Mr. Axelrod talked about the historical background of Beach Point Capital Management and about the investment process for the Total Return II Fund, the philosophy and the client institutional framework. This was followed by a question and answer session with the Board.

Staff's recommendation was for a $30.0 million investment in Beach Point Offshore Total Return Fund II, Ltd.

Mr. Dubow requested a motion. Mr. Stagliano made a motion to approve Staff's recommendation to invest $30.0 million in Beach Point Offshore Total Return Fund II. Mr. Albert seconded. Mr. Dubow requested a Board vote. Ms. Pankey and Ms. Stukes abstained. All others were in favor. The motion passed.

Agenda Item #3 – Small Cap Value Search Recommendation

Mr. Handa advised about Staff's Small Cap Value search which included finalist presentations made by Fisher Investment Asset Management, LLC, NewSouth Capital Management, Inc., and Snyder Capital Management, at the May 1st, 2012, Subcommittee meeting

Mr. Falkowski provided Staff's criteria for measuring the finalists' performance, with their recommendation to retain Fisher Investment Asset Management, LLC. He advised that

Staff was considering replacing Lee Munder Capital Group with NewSouth and would be presenting at the next Investment Committee Meeting.

Mr. Dubow requested a motion. Ms. Stukes made the motion to retain Fisher Investment Asset Management, LLC, in the Small Cap Value space. Mr. Albert seconded. The motion passed.

Agenda Item #4 – General Consultant Performance Report for the 1st Quarter 2012

Mr. Nesbitt reported that 1st Quarter performance (Page 2) was good, but turned south in May. He provided Cliffwater's report for the periods ended March 31, 2012.

The markets were (Page 3) still driven by the U.S. Equity market, and for the 1st Quarter of 2012, the Russell 3000 Index and the MSCI Index were up by double-digit returns. In April the equity markets posted negative returns, and in May they were sharply negative, about -6%. Approximately 1.5 months was left to the fiscal year, with the hope of a turnaround, but currently from a total return perspective, not promising. High Yield bonds did well in April. They were down a couple of percentages in May and held up well for the last fiscal year. Hedge Funds were roughly flat. The returns were up for the 1st Quarter, and in April were flat. For May, Hedge Fund returns were zero to -1%. Most of the Fixed Income portfolio did well, and High Yield remained the best performing group, but Treasuries were doing well in May. Commodities had been flat throughout the year, in April and in May, fell significantly. The Equity Markets, year-to-date, through April were fairly flat, with (Page 4) changes in May.

Mr. Nesbitt reminded about the scheduled asset allocation study and that Cliffwater's major concerns were de-risking the Plan, without forfeiting expected return, as well as diversifying the portfolio to make sure that it did better during dislocations, such as that seen in May.

He highlighted (Page 7) Mr. Walthour's report for top performers for the quarter, which included Emerald, Fisher, Trilogy and Rhumbline. The bottom performers in the portfolio were Western Asset Management and Regiment.

Mr. Nesbitt reported that the total Fund assets (Page 9) at the end of Quarter were $4.15 billion. The report was showing current individual asset classes versus their targets. The Fund was overweighted in Domestic Equity, underweighted in Non-U.S. Equity, with a difference of 3% to 4% percentage points and that helped performance. The overweight versus target in Fixed Income also helped. There was a slight underweight in Real Estate, a slight underweight in Private Equity, an underweight in Hedge Funds and there was an overweight to cash. Adding them together, there were more positives than negatives.

He added that (Page 10) Cliffwater was looking to present the Quarterly reports to the Board, working with Staff to simplify, without eliminating important information. The focus would be on two columns, year-to-date through March and the fiscal-year-to-date, looking at Total U.S. Equity, and adding a row for net of fees to show performance net of fees, as best practice. Staff and Cliffwater would, also, like to simplify some the benchmarks. They recommended adding the ten-years and eliminate the trailing one-year row. The three months was fine. Their focus would be on the value-added for each asset class, as to whether or not they added or subtracted value, net of fees.

Total U.S. Equity, value-added was positive, but slightly negative fiscal year-to-date and for the one-year. The five-year was positive, but since inception, 25 years, it was a small negative. Value-added for the Non-U.S. Equity portfolio, in terms of active management, was positive in all periods and since inception. Their goal would be an improvement of one-half of 1%.

Mr. Dubow asked Mr. Nesbitt if the manager did not add value in equity, should the Board go to the index fund. He said, yes, because it was an efficient asset class, where it was difficult to find managers. Cliffwater recommended a high allocation to index funds, with respect to the U.S. Equities.

For Total Equity, the numbers were positive over the longer-term periods. For the fiscal-year to date and the one-year, it was negative by 3%. Mr. Nesbitt addressed Mr. Dubow's question as to the accuracy of Total Equity results for the fiscal-year and one-year, noting that their report calculated the benchmark, drawn from the -2.3 and -2.5 from the fund's former custodian, and with the transition period, they would measure the numbers for accuracy for the next Investment Committee Meeting.

Global Fixed Income had not added value, and would be complimented by adding funds, with firms such as Beach Point Capital that specialized in credit. Cliffwater's advice was a straight index fund.

For the Total Alternative Investments, Private Equity, of over one-half billion dollars, was shown versus the S&P and was like apples to oranges, and Cliffwater recommended another benchmark for Private Equity. The portfolio was very good and over the last ten years through December 31, 2011, the numbers were high, around 10%. He said that Private Equity had been one of the best performing asset classes, and Cliffwater would consider that as reviewing the asset allocation. He cautioned about how Private Equity sapped liquidity.

Cliffwater had not done a complete review of Real estate, with $168.0 million invested, and the results were volatile over the last five years, with the breakdown in the commercial and the real estate markets. Their feeling was that the asset class had not contributed as it should, and they would have a recommendation during the asset allocation review. Real Assets was very good with strong cash flow, and MLP's had been a popular asset class since it started with the Fund over the last six months. The total Hedge Fund portfolio for the five-year performance and fiscal year-to-date was not stellar. Staff and Cliffwater could dramatically improve performance by a few points. Staff's recommendation to liquidate the fund-of-funds portfolios was a huge plus, in terms of eliminating the intermediary fee and increasing performance going forward.

Mr. Nesbitt noted Staff's article and analysis on Artio Global Management, the Fund's High-Yield bond manager, showing that their value-added was significantly negative, in coming out of the three-year period since 2009. The number was significant. Cliffwater's recommendation to Staff was to postpone further action until the asset allocation study, because the Board might not want to include that type of manager.

At 11:00 a.m., Ms. Weiss briefly recessed the meeting. They returned at 11:25 a.m.

Agenda Item #5 – 1st Quarter Domestic Equity and Fixed Income Market Updates

Ms. McNavish reminded from last report that Staff covered International Equity and Real Assets.

Mr. Falkowski advised that Staff's recommendation for Turner Small Cap Growth was to maintain Watch #2 status, and to issue a Small Cap Growth search to evaluate other candidates. He said that action could wait until the asset allocation study.

He reported that at the firm level, there were no major changes, except that one of the analysts left the firm. During the 1st Quarter, the manager gained a little over 12%, gross of fees, and underperformed by, approximately, 100 basis points. Overall, since inception of 1998, they were at 362 basis points ahead of the benchmark with strong outperformance since inception, the five-year number was showing the manager a little below the benchmark as well at the 3rd quartile.

Ms. McNavish informed that the Lombardia account was transitioning to O' Shaughnessy on the Large Cap Value side, and that O'Shaughnessy will be funded soon.

She advised about the article on Artio Global Management in the CIO's report and reported that Artio's gross of fee numbers since inception were 343 basis points below the benchmark. The firm had been losing assets. Under Assets Personnel update note that net firm flows were negative $380.0 million in the 1st Quarter and a negative $980.0 million in the 4th Quarter of 2011. Staff noted that the negative asset flows had not been in the High Yield product, but rather had occurred in the International Equity product. Total firm assets stood at $34.0 billion at the end of March 2012, and Staff was watching. If firm outflows were to become a major concern, Staff would not hesitate to act, but currently Staff was comfortable waiting. The firm was placed on probation six months ago related to performance. She said that Staff was currently conducting and reviewing responses to the High Yield search.

With Stone Harbor, there were issues with performance reporting. The manager reported a return of 8% in the quarter compared to State Street's reported return of 10. Staff would provide more information at the June meeting with the reconciled numbers.

Western Asset Management underperformed the benchmark for the Quarter, and was placed on probation six months ago. Staff was considering that there were few managers in the global inflation indexed bond space and would like to wait until after the asset allocation study before conducting a search.

Board discussion was about the asset allocation study and whether or not it was anticipated that there would be an increase in the allocation to private equity. It was determined that would be answered once the asset allocation study was complete.

Agenda Item #6 – Private Markets 4th Quarter 2011 Portfolio Report and 1st Quarter 2012 Update

Mr. Atkins summarized performance, with a couple of highlights of the Fund's recent Emerging Market manager performance, followed by Mr. Woolworth's report on recent cash flows, trends and activity.

Fund performance over multiple horizons was showing (Page 6) for the last 12 months, good returns for the portfolio, earning a 12.3% net return through December 31, 2011, and, since inception, earned 9.2% versus the S&P 500 for decent 1st Quarter returns.

Manager performance (Page 32) was highlighted, showing how recent managers' vintage 2007 and 2008 portfolios were performing, holding at 12.3% for 2008 and 13.4% for 2007 and, overall, did well. They were relatively young vintages, but doing well for the Fund.

Mr. Jackson reported for the 2008 portfolio that the Relativity Fund, an emerging manager Buyout firm, had not performed well. The City committed $15.0 million to the Fund, and had contributed approximately $7.2 million for existing investments. The current value of the investments was $3.7 million, generating a multiple of cost of 0.5x and a negative 30% net internal rate of return. The team has struggled to produce attractive results, as out of the seven total investments, two have been significantly written down and two more have been written off.

The Board sought advice from Franklin Park about the remaining unfunded capital commitment to Relativity. Mr. Jackson said that illiquid private equity investments would be tough to exit in the marketplace. Mr. Atkins cautioned that if the Board sold it, it would be for a value beneath the amount that was quoted. Due to Relativity's performance, the Board might have to pay the buyer to take it over because of the unfunded risk..

Ms. Weiss asked the Board members if they were in agreement in requesting Franklin Park to make the effort to work with the other Limited Partners of the fund to help salvage the remaining $7.8 million in unfunded commitments to Relativity. They were in agreement.

Mr. Jackson reported positive results for the 2007 vintage-year portfolio manager, Vista Equity III, an African American-owned and managed Buyout fund.

Mr. Woolworth reported that coming out of the downturn, legal amendments to existing private equity partnerships were increasing as firms began to seek compliance with the new Securities and Exchange Commission's regulations.

For cash flows, approximately, $19.0 million was contributed during the 1st Quarter of 2012, which was slightly down from prior Quarters. In previous Quarters, distributions from distressed security focused investment Managers resulted in the Fund getting huge capital distributions back as markets improved from the lows experienced in 2009 and Managers sought to liquidate portfolios at a significant profit. As this activity is beginning to level off, distributions are beginning to normalize.

On a net basis, the Fund was relatively positive over the last six Quarters, except for the 3rd Quarter of 2011 when the broader markets saw sharp declines in value. Net cash flows were positive for the 1st Quarter at $12.7 million, matching the 4th Quarter results. Staff noted a slight downward trend in the cash flows, and will continue to watch for any changes in the market that may result in a drop-off in distributions. Cash flows have been strong, and the Fund has a fairly stabilized Private Markets portfolio.

<u>Agenda Item #7 – Real Estate 4th Quarter 2011 Portfolio Report and 1st Quarter 2012 Update</u>

Mr. Foulkes informed about the incorrect market value of $10,057 for Mesa West on page 2 of the Staff Update, and that the correct market value should be over $10 million. This made the portfolio total off by $10 million, and the real total should be $169 million.

Mr. Rivitz (page 1 of the Courtland report) reported that the 4th Quarter of 2011 was good, returning 3.1% compared to all of last year at 9.6%. The difference was due to income staying similar to all of last year at 1.1%, but appreciation jumped to 2.2% for the 4th Quarter compared to 6.4% for all of 2011. The returns increased in one year by, almost, 10%. The two-year return was 12%. The current Market Value of the portfolio was almost $167.0 million as compared to the last Quarter amount of $148.0 million. The majority of the new capital that was committed was to existing funds, including $10.0 million more to JP Morgan that was funded in the 4th Quarter. There was some appreciation, but mostly new capital coming in to previously allocated, but not funded, commitments.

The Fund (Pages 2-3) versus the policy statement and other benchmarks, was showing that the Fund trailed the benchmark, attributed to dynamics in the timing aspects of investing in Real Estate, prior to Courtland. The Fund equity multiple was less than one dollar, and if the assets were re-valued, it would be down to zero for a lot of the investments. The good news was that there was room for improvement. Courtland would be moving forward with better income funds and better investments.

For the Fund (Pages 4-5) compared to its policy statement and benchmarks, in terms of property and geographic sectors, to date the Board approved, roughly, $240.0 million in commitments, with $45.0 million being Courtland's investments. The Board invested almost 90% of the commitment amount, excluding the 1st Quarter new investments that will be included in the next Quarter. The Fund was close to the market breakout between Core, Value and Opportunistic of 40-50-10. The Fund (page 5) was underfunded in retail and residential compared to the benchmark, (page 6) as well as in the Midwestern and Southern areas and in the foreign categories.

Overall, it was a good Quarter, but there was still a lot of work to do with some of the funds.

Mr. Novick informed about the recent lawsuit filed in Oregon, where the Oregon Public Employees Retirement Fund is a defendant in connection with its investment in a prior Lone Star fund. Courtland Partner's general counsel would distribute a memorandum to all of their clients about the facts, with their analysis, but they did not believe that it was material.

Mr. Foulkes (page 5 of the Staff Update) reported on valuations in the Fund's investment in Beacon Capital Strategic Partners V. Another Fund investment, Tishman Speyer European Real Estate Venture VI, sold their investment in a City of London office property, CityPoint, at a profit to Beacon V, but Beacon V experienced difficulty in restructuring European commercial mortgage-backed securities debt, with Beacon V writing the market value down to zero. They defaulted on the last two loan payments and were not able to get a loan modification, as was reported on the front page of the *Money and Investing* section of *The Wall Street Journal* on May 16th. Mr. Novick said that it was included in the -2% [for the Quarter for Beacon V].

<u>Agenda Item #8 – 1st Quarter 2012 Opportunity Fund Report and Flash Report for Opportunity Fund Managers for the Period ended April, 2012</u>

Ms. Cherry reported for FIS, and Mr. Spagnola reported for PFM.

Ms. Cherry reported total Opportunity Fund assets as of March 31, 2012, at $219 million. Gross of fees, both managers outperformed their respective targets, but, net of fees, both slightly underperformed.

Ms. Cherry reported that the V.P. of Marketing & Client Service left FIS for personal reasons. Investment personnel were not affected. Five of the managers slightly underperformed their benchmarks, Martin Investment Management, Edgar Lomax, Herndon International, and Victoria 1522. There was no concern with the managers.
There was slight underperformance for Moody Aldrich in April, attributable to a mortgage investment.

She reported overall favorable performance, since inception, and added that the performance for April was good.

Mr. Spagnola reported for PFM, as of March 31, 2012. The overall Fund did well in the Quarter, at 10.31 versus the benchmark of 9.89%. All asset classes were additive in the Quarter. Domestic Equity beat the benchmark by a little over 1% and returned 13.29%. International Equity returned 11.28, beating the benchmark of 42 basis points. Fixed did well, beating the benchmark by 25 basis points.

Six of the ten managers beat the benchmark for the Quarter. Most was in Domestic Equity, where three outperformed and two underperformed. .

He advised that PFM was looking at existing emerging managers and more minority firms to make sure that they were up to date on the manager universe.

He informed about a new hire to PFM, who was formerly the Director of Research for the Federal Reserve Bank on the Client Benefit Fund based in New York.

He provided a brief background on Nichols, identifying the firm as women-owned and based in Boston. He talked about the composition of the firm and their management style. The funds from Geneva, who graduated into the general fund, were invested with Nichols for, about, one month and a half.

Mr. Spagnola concluded by saying that PFM continued to monitor the portfolio in providing weekly reports to Staff and continuing to focus on other areas where they could add value, both at the manager level, and in terms of overall allocation to the fund. Currently, they were managing close to the benchmark, in terms of capitalization and the breakout between Domestic, International and Fixed Income.

Agenda Item #9 – 1st Quarter 2012 Directed Commission Report

Mr. Falkowski reported on the local minority brokerage program, saying that for the second consecutive Quarter, the Fund's Equity managers met their 25% target, during the 1st Quarter. The Opportunity Fund managers had the highest allocation at 34%.

The report (Page 3) included information about the newly funded Fixed Income managers. He noted that Staff was able to implement Rhumbline Core Bond Fund into the portfolio under the program. They were recently funded as a separate account manager. Both Rhumbline and Merganser were cumulatively well above their target at 51% for the 1st Quarter.

The Fund recaptured a little over $29,000.0 during the 1st Quarter. This represented, approximately, a 40%, increase from the 4th Quarter, due to an increase of commissions, as well as an increase in the overall percentage versus last Quarter.

Agenda Item #10 – Chief Investment Officer's Report

Mr. Handa reported that securities lending income was approximately $33,000 for the month of April, down from the roughly $130,000 a month in income produced under normal lending conditions. The decline in income was primarily related to the transition from State Street to JP Morgan. The decline is attributable to the arbitrage, in terms of the securities on loan having to sell-off at State Street and then subsequently buying-in to go back on loan with JP Morgan. In May, as of last week, representing the first 11 days of the month, the Fund was back on track at approximately $60,000 in income. It is anticipated that securities lending income for May will be at or above median, getting back to the level of normalized income seen in January and February.

He advised that Mr. Woolworth and Staff were working on the numbers for the minority and local managers and were looking for greater clarity and specificity with more details going forward.

Mr. Handa talked about the recent media coverage of JP Morgan, saying that Staff consulted with them, related to the Fund's assets Real Estate and Currency Overlay and the question about whether or not the Fund had exposure to recent trading losses in the CIO group. He advised that when he, Mr. Bielli, Mr. Leonard, and Mr. DiFusco negotiated the contract, they included the requirement that the Fund's assets be segregated. The Fund's assets were not commingled with CIO assets that were lost. He advised that Staff would invite JP Morgan to talk at the June meeting about how the custody assets were segregated and not commingled.

He informed that since JP Morgan was up and running, the Independence Fund was up and running as well. Staff was investing in the markets, and would provide monthly reports to the Board, and to the Executive Committee on a daily basis. The Fund consultant is acting as Risk Manager and monitoring the transactions of the Fund, as well as JP Morgan.

Mr. Handa touched on the inclusion of the article about Artio and referenced the issues and concerns related to Artio Global Management noted in both Cliffwater's and Ms. McNavish's reports.

The Board agreed that the meetings could be changed to June 27th, July 26rd and August 30th.

At 12:42 p.m., Ms. Weiss requested a motion to adjourn the Investment Committee Meeting. Mr. Albert made the motion. Ms. O'Leary seconded. The motion passed.

At 12:42 p.m., Ms. Weiss requested a motion to reconvene the Board of Pensions and Retirement Meeting to affirm the actions taken at the Deferred Compensation Plan Committee Meeting and the Investment Committee Meeting. Mr. Albert made the motion. Mr. Stagliano seconded. The motion passed.

At 12:42 p.m., Ms. Weiss 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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Paula Weiss, Esquire
Alternate Board Chair