THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
JULY 26, 2012

MEETING MINUTES

There being quorum, Paula Weiss, Esquire, Alternate Board Chair, opened the Investment Committee Meeting at 9:35 a.m., 16th Floor, Board Conference Room, Two Penn Center Plaza.

Present:

Rob Dubow, Director of Finance, Board Chair
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, Board Vice Chair
John A. Reilly, Employee Trustee
Carol G. Stukes, Employee Trustee
Veronica 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 Officer:	Daniel Falkowski
Investment Associate:	Dominique A. Cherry

Also Attending:

Robert O'Donnell, O'Donnell Associates
Christopher DiFusco, Esquire, Law Department
Katherine Mastrobuoni, Esquire, Law Department
Nicole Morris, Law Department
Jacob Walthour, Cliffwater
Ashley Cooke, Cliffwater
John Spagnola, PFM
Marc Ammaturo, PFM
Stuart Cameron, PFM
Steven Novick, Courtland Partners

Ben Blakney, Courtland Partners
Tina Byles Williams, FIS
McCullough Williams, FIS
Shalonda Epps, FIS
Larry Bernstein, FIS
Arlene Sawyer, Investments
Donna Darby, Investments
Carmen Heyward, Investments
Andrew Thomas, Local #22, Firefighter
Chester Skaziak, Retiree, Firefighter
Will Greene, Loop Capital
Arnold West, ING
Catherine Lucey, Philadelphia Daily News

Agenda Item #1 – Approval of Minutes - June 27, 2012

Ms. Weiss opened the meeting and requested a motion to approve the June 27, 2012, Minutes. **Mr. Reilly made the motion. Ms. O'Leary seconded. The motion passed**.

Agenda Item #2 – Turner Small Cap Growth Staff Recommendation

Staff's recommendation to the Board was to terminate Turner from the Small Cap Growth strategy. Staff's report showed that Turner underperformed the benchmark, net of fees, on a trailing three and five-year basis, and that the manager was on Watch -2 status.

Mr. Handa shared the results of their two meetings with Turner, over the last seven months, that led to the recommendation. Primarily, the response of the portfolio manager led Staff to question whether or not the performance was driven by the portfolio manager or by the analysts. It belied the risk that the portfolio manager was dependent on the analysts, and, if the analysts were to leave, what would happen? Additionally, the manager did not seem to have a full understanding, in Staff's opinion, of the portfolio content. He cited Ms. McNavish and Mr. Falkowski's observations, as highlighted in Staff's memo, that the risk-reward was not that compelling in some of the situations where they did have investments.

Staff's recommendation was to terminate the relationship with Turner and to put the proceeds into a Russell 2000 Growth Index Fund with Rhumbline, where the performance of the product was equivalent to Turner, if not better.

Board discussion centered on the possibility of issuing a Small Cap Growth RFP after the new Asset Allocation Study is approved, which is expected to occur at the October 2012 Board meeting.

Mr. Stagliano made a motion to terminate their relationship with Turner Small Cap Growth and put the money in an index fund. Mr. Rice seconded. Ms. Weiss requested a Board vote. The motion passed.

Agenda item #3 – Courtland Report on the Real Estate Program

Mr. Blakney provided an overview of the Fund performance measurement report. He talked about the valued relationship with the City of Philadelphia, saying that Courtland would respond to the RFP at the expiration of their contract, August 31, 2012. The presentation included a snapshot of the current portfolio.

Mr. Novick bifurcated the performance of the City's portfolio into pre-Courtland and post-Courtland, focusing on the legacy portfolio. In comparing the numbers, the report was showing that the numbers jumped off the page, the difference before and after engagement with Courtland. He noted that while Courtland could not pound their chest for market conditions, they did for making solid investment recommendations.

He reported on the funds that Courtland put into place with Staff, noting that every one of the funds were performing as targeted, with a projection that they would meet, if not exceed, their target. He noted that during 2011, they brought a lot of top tier managers to the Board, a majority of which were passed off, which was frustrating to Courtland. Lone Star, to date, was not going to be good, but in looking deal-by-deal on the dollars they were getting out of the door, based on distressed debt and the market, they were going to do terrific. Mesa West performed exceptionally well, providing an 8% yield.

Mr. Novick introduced Mesa West Fund III, advising that Courtland successfully negotiated an aggregation agreement with Mesa West that provided significant savings with clients who invested in that fund under the Courtland umbrella.

Mr. Blakney (page six) presented a comprehensive snapshot of the universe of Courtland investments that homogenized vintage-year activity, compared to the same vintage years that impacted the Fund's performance. In looking at the one, two, three, four and five-year performance and inception to-date, it was showing 5.8 for Courtland and -10.7, in terms of the legacy portfolio. In looking at risk strategy, he noted significant challenges to the Fund, saying that the Board wanted to use a different approach to the standard Core investment strategy that would suggest thinking outside the box. In looking at the Value, Opportunistic and other types of investment strategies in real estate, Courtland's report was showing that, of the, approximately, $34.0 billion that they recommended from 2006 to 2012, 85% plus had been identified with the Value and Opportunistic risk strategies. He noted that the sweet spot of both what would be the strategic planning and the tactical execution platform for Courtland was perfectly aligned with the direction that the Board's Real Estate portfolio was moving.

Mr. Novick talked about Courtland's negotiation of fee reductions for Lone Star, to the benefit of the fund, and Distressed Debt opportunities that addressed that more money was needed in the portfolio. He said that new ones were coming out all of the time and Courtland was bullish on that as a continuous investment, and that the ability to take advantage of those distressed debt plays, both domestically and internationally was becoming terrific.

He concluded that even though there were gaps in the portfolio, there were still good opportunities with top quartile managers. He thanked the Board for the opportunity to work with them over the years, and they hoped to continue.

At 10:33 a.m., Mr. Dubow recessed the Board for Executive Session. The Executive Session ended at 10:50 a.m. Ms. Weiss chaired the meeting after Executive Session.

Ms. Weiss stated that the purpose of the Executive Session was to discuss litigation matters.

Agenda Item #4 – Opportunity Fund Manager Presentation

PFM and FIS presented their Quarterly numbers, with a review of their process of evaluating managers, followed by Board questions and comments.

PFM talked about their process of monitoring managers in light of recent performance issues. They provided an update to the portfolio activity.

Mr. Spagnola reported on the overall Total Fund, with some market commentary. Overall, the fund was down 307 basis points for the quarter versus the target policy benchmark which was down 283 basis points for the quarter. Year-to-date the fund is up 693 basis points and was 15 basis points ahead of its target.

Mr. Dubow asked Mr. Spagnola what qualified a manager for PFM's Opportunity Fund. He said that it was a mandate that they were given by the City of Philadelphia, and they looked for emerging managers, mostly, minority or women-owned firms.

Ms. Stukes asked Mr. Spagnola if PFM used the Russell 3000, or generalized it, because most of them were saying Russell 1000. Mr. Spagnola responded that the Target Policy Index was the Russell 3000, and then it was broken down to a specific benchmark of the Russell 1000 Growth, Russell 1000 Value and the Russell 2000 Value or Growth.

Ms. Weiss asked Mr. Spagnola how long did it make sense to hold managers, or how did they evaluate them, and what was their process for looking at them. He said that PFM tried to give the managers three years or a market cycle. They ranked their managers, using one for recommending managers, two for a manager that they used, three was a watch list, four was probation and five was termination. Two of the managers, Marvista and Palisades were on Probation and the managers were aware of both PFM and the Board's concern for underperformance.

Mr. Spagnola provided the total portfolio performance.

He informed the Board that Profit was moved from Probation to PFM's Watch List and that Palisades and Marvista had been placed on Probation.

Mr. Handa requested a beta of the portfolio. Mr. Spagnola said that he would provide that.

Mr. Spagnola provided PFM's updated (as of last Friday) report on their weekly track of managers, and the total fund was 52 basis points ahead of its benchmark for the month of July.

Ms. Stukes asked Mr. Spagnola to provide the Board with a list of the firms based in Philadelphia that would fit the investment criteria.

Mr. Williams introduced FIS presenters and provided a brief overview of investment personnel changes, internal operations, new managers followed by a discussion about FIS' evaluation process.

Ms. Williams prefaced her presentation by talking about FIS' emerging fund-of-fund manager, top-down strategy process.

Mr. Dubow asked Ms. Williams what qualified managers to be in the Opportunity Fund. Ms. Williams described how FIS' research analysts found the best firms and screened them within their categories through a proprietary database. The scoring process looked at their investment philosophy, their organizational dynamics, solvency, their buy and sell discipline, their drawdown and the quality of their individual depth of style. She described it as a six-month process where the analysts wrote a due diligence package to present a manager to the investment committee, and after their review, if they liked the presentation of the product specialists, they brought in the manager.

Mr. Walthour asked Ms. Williams if there were specific categories of managers they looked at for the Opportunity Fund that might differ from other clients. Were they looking for women, minorities, and local managers? What were the categories of managers or the criteria by which she defined emerging? She said the classic definition of emerging was $2.0 billion and under, and they looked within that range. She said that the categories that he mentioned mattered in how the fund was constructed, as opposed to selecting managers, and if a client said that they would like to see a majority of local, minority or women, FIS would construct the fund, if they could; because, there were some categories that were not robust.

Mr. Bielli asked Ms. Williams how long they tracked manager performance. Was it on a daily, weekly or monthly basis, and if FIS did a utilization study and knew a ballpark figure of companies based in Philadelphia that fit the criteria of the Opportunity Fund. How many of them did the Board have in the FIS portfolio? She said that it was done monthly, minimally. To his second question, she said that there were not many. Mr. Bernstein said that they had their eyes open to try to find more managers.

Ms. Stukes requested a database, related to Mr. Bielli's request, of Philadelphia proper companies. Mr. Bielli asked how many of the firms in the FIS Opportunity portfolio were minority and women-owned firms? She named the firms and said, about, 70%.

Ms. Stukes asked Ms. Williams if FIS used the Russell 3000 for all of their managers, or did the Russell 3000 have a major component, with them breaking it down over the Russell 1000 and the Russell 2000 that made a combination of the Russell 3000. Ms. Williams said that would be the latter.

Ms. Williams' market commentary highlighted the 2nd Quarter as troublesome for the Fund's managers. There was a complete reversal of sectors, and whatever did well in 1st Quarter did badly in the 2nd Quarter.

She said that the Fund's allocation performance was showing that most of the trouble was in the U.S. component of the portfolio. The Non-U.S. component had been swimming pretty well, and, as of June, on a net of fee basis, -17 basis points behind the benchmark and 55 gross of fees above the benchmark.

Mr. Handa asked Ms. Williams for a beta of FIS' portfolio. Ms. Williams said that it was 1.02.

Mr. Dubow asked Ms. Williams how did FIS decide when they needed to get rid of a manager. She talked about Moody Aldrich and said that they were on probation. The process is if there were two successive quarters of underperforming the benchmark and peer group, they were put on watch. If there was something peculiar about the nature of the manager's downdraft, they were placed on probation. The reason that they were replacing them was that they were losing more in the down market than they were gaining.

Mr. Bernstein reported for the three months of the 2nd Quarter that two of the seven Domestic Equity managers outperformed. However, on the Non-U.S. side, all four of them outperformed for the 2nd Quarter. For the Quarter, six of the Fund's eleven managers beat their respective benchmarks.

Ms. Williams concluded in saying that the 2nd Quarter was a tough period, and FIS appreciated the Board's confidence. She noted that they had a long way to go to dig out, but made great strides in digging out of the hole that was created in May.

Agenda Item #5 – Flash Report for the Period Ended June 2012

Mr. Handa reported that the Fund was down.05% for the year ended June 2012, which also represented fiscal year-to-date performance. Mr. Handa noted that the Board would have June Private Equity and Real Estate values in January, because of the six-month lag. Mr. Handa noted that the hedge fund portfolio did not include KKR, as KKR was funded in the middle of June. The numbers presented for hedge funds are on a one month lag and reflect May values. Mr. Handa noted that to put performance into context, Calpers, which is one of the largest pension plans in the country, was up 1.8 percent, over the same period time period. Obviously, they were running approximately $230.0 billion and their funding status was different than that of the City's. However, in 2010 and 2011, the Fund underperformed Calpers by 300 basis points.

Mr. Walthour provided a brief market commentary. He noted, as discussed during PFM's and FIS' report, the high degree of correlation amongst individual stocks. His thought was that high correlations drove the results of a lot of the equity managers, which had nothing to do with their skill sets. It had all to do with what was happening around the world.

The performance of the Fund's TIPS portfolio was negative across different time periods, which Cliffwater would be discussing. Within Alternative Investments, REITS had been a phenomenal performer. The Long-short Equity Hedge Fund Index held their own at around 2% year-to-date, but underperformed the S&P 500 Index, primarily because the short side of the portfolio hurt them. Event Driven managers were negative year-to-date.

The Non-U.S. Equity managers were top contributors within the Fund during the month, as was Emerging Markets Debt. One of the Fund's Large Cap Value managers, Aronson, Johnson & Ortiz had good performance, as well. Hedge Funds represented the worst contributors to performance within the Fund for the month. Ms. Cooke noted that was based on June performance estimates for hedge funds, whereas the Flash Report numbers included May's numbers for hedge funds.

Mr. Walthour said that total fund performance for the month was down 63 basis points relative to the benchmark, and up about six basis points fiscal year to date, relative to the benchmark. Mr. Walthour noted that the longer term numbers were concerning, because the Fund was squarely behind the benchmark over the longer term.

The Domestic Equity asset class underperformed the benchmark for the month. For the fiscal year-to-date, the asset class was down by about 160 basis points versus the benchmark. In thinking about the size of Domestic Equity within the portfolio, that was real money that was left on the table. Non-U.S. Equities were slightly positive relative to the benchmark fiscal year-to-date, although negative for the month. Fixed Income did well fiscal year-to-date, up about 15 basis points as well as for the month. The Opportunity fund underperformed its benchmark for the month and fiscal year- to- date. Hedge Funds did well relative to their benchmark, and MLP's struggled relative to their benchmark. Mr. Walthour noted that the Real Estate and Private Equity numbers for June were not reflected yet.

Mr. Walthour noted that a large number of managers were underperforming at a level and over a time period that was concerning. When they talk about the asset allocation, they will take a look at where the Board could have success in picking active managers. They will talk about where the dollars should be allocated, in terms of asset classes and focus on how things will be implemented. He noted that it was not just a cost savings issue, but a performance issue. The magnitude of the performance was worth looking at within the next 90 days.

Mr. Walthour talked about Western Asset Management in the Fund's TIPS Portfolio, which showed underperformance relative to the index across the board.

Board discussion about Western Asset Management came to a motion to terminate the manager.

Ms. Weiss requested a motion. Ms. Stukes made the motion to terminate Western Asset Management TIPS. Mr. Reilly seconded the motion. Ms. Weiss requested a Board vote. All were in favor. The motion passed.

Mr. Walthour said that the money would be put with a Fixed Income manager**.**

Mr. Walthour said that the Independence Fund was a long-short fund, as it was currently constructed. He said that there were long stock positions and short positions. Cliffwater did not believe that the Independence Fund should be compared to the S&P 500 Index, although that was the benchmark that Mr. Handa compared himself against. Cliffwater's recommendation from a risk management standpoint was that it should be judged against a benchmark for the strategy. Mr. Handa indicated that the HFRX Event Driven Index compared and was appropriate. It was decided that the HFRX Event Driven Index would be used.

Ms. Weiss requested that the Independence Fund be compared to both the S&P 500 Index and the HFRX Event Driven Index in the report.

Ms. Pankey asked where the Independence Fund would be if they used the index that Cliffwater recommended. It was the same index that Caspian was benchmarked against. It was also decided that May 1, 2012 was the actual inception date for the Independence Fund.

Mr. Walthour responded to Mr. Stagliano's question about whether or not Cliffwater looked at the daily positions of the Independence Fund from JP Morgan every month. He said that every month the analyst at Cliffwater that was assigned to the Independence Fund called Mr. Handa to review what worked or did not work in the portfolio, how the portfolio was positioned, and what was Mr. Handa's outlook. A meeting with Cliffwater and Mr. Handa was scheduled for August 9th . Mr. Handa had a monthly call on Friday. Mr. Walthour said that Cliffwater gets the actual trades of the Independence Fund. Ms. Pankey stated that she wanted to follow up on a previous statement made by the CIO to provide information about the Independence Fund.

Ms. Stukes requested a quarterly report about the Independence Fund investments.

Ms. Cooke confirmed that Cliffwater would include the S&P 500 Index and the HFRX Event Driven Index on the next report.

Agenda Item #6 – Chief Investment Officer's Report

Mr. Handa advised that JP Morgan was curious as to how their presentation went, and he requested that the Board members send their comments, complaints or criticisms to him about their presentation.

He reported Securities Lending income for June at $255,084. The Securities Lending income is almost twice the amount earned in June of last year.

He invited questions about Mr. Woolworth's local and minority report. He advised about Mr. Woolworth's informal visit to the Board's manager, Baring Asset Management, in London and noted this trip was not funded by the Pension Fund but part of a trip funded by ILPA. He commended Mr. Woolworth's effort, noting that no one had visited the manager, even though the Fund was substantially invested with the manager.

Mr. Handa revisited the Independence Fund performance numbers. The Fund was up about 84 basis points and was being run as a long-short fund, with 14 positions on the long side and 12 on the short side. The Fund was flat since inception, May 1st. Of the $43.0 million, $33.0 million was invested, leaving $10.0 million. The market was down approximately 5% over the period of time. He said that each one of the ideas had a catalyst. Ms. Pankey asked that the record reflect that she did not want to appear as though she was honing in on Mr. Handa, but rather wants to make sure that the Independence Fund is treated the same as any other hedge fund.

Mr. Handa said that there were no surprises to anyone on the Executive Committee. He reminded the Board about the levels of monitoring related to the Independence Fund trades, with the Executive Committee, JP Morgan and Cliffwater receiving the trades. He informed that since the Independence Fund started investing, there had been about one trade per week.

Ms. Weiss advised that the Asset Allocation Study, scheduled for September 19, 2012, would be held from 10:00 a.m. to 1:00 p.m. and that a confirmation would be sent to the Board members. The next meeting will be held Thursday, August 30, 2012.

New Business

Mr. Stagliano noted that the election ballots would be received by October 10, 2012. He asked what day they were going to count them. Mr. Bielli said that he would find out.

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

THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
JULY 26, 2012

At 12:30 p.m., Ms. Weiss reconvened the Board of Pensions and Retirement Meeting to affirm the actions taken at the Deferred Compensation Plan Committee Meeting and the Investment Committee Meeting. Ms. Stukes made the motion. Mr. Stagliano seconded. The motion passed.

At 12:30 p.m., Ms. Weiss requested a motion to adjourn the Board of Pensions and Retirement Meeting. Mr. Albert made the motion. Ms. Stukes 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