THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
SEPTEMBER 25, 2012

MEETING MINUTES

There being a quorum, Paula Weiss, Esquire, Alternate Board Chair, opened the Investment Committee Meeting at 9:28 a.m., 16th Floor Board Conference Room, Two Penn Center Plaza.

Present:

Paula Weiss, Esquire, Alternate Board Chair
Harvey Rice, Esquire, Alternate, First Deputy City Controller
Brian Albert, Alternate
Hillary Cornell, 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 Officer:	Daniel Falkowski

Also Attending:

Christopher DiFusco, Esquire, Divisional Deputy City Solicitor
Katherine Mastrobuoni, Esquire
Jacob Walthour, Cliffwater
Ashley Cooke, Cliffwater
Andrew Thomas, Local #22, Firefighters
Arlene Sawyer, Investments
Donna Darby, Investments
Carmen Heyward, Investments

Agenda Item #1 – Approval of Minutes – August 30, 2012

Ms. Weiss opened the meeting and said in light of various schedules for some of the Board members, particularly, the First Deputy City Controller, the action items would be first, starting with Agenda Item #2, Real Estate Consultant Search.

Ms. Weiss opened the meeting and after Agenda Item #2 requested a motion to approve the Minutes of August 30, 2012. Ms. McNavish requested a substantive change to page three, under Agenda Item #3, second paragraph, from “six points” to “six basis points” and noted that revised minutes reflecting the change were in the trustees’ folders.

Mr. Albert made the motion to approve the minutes with the substantive changes. Mr. Stagliano seconded. The motion passed.

Agenda Item #2 – Real Estate Consultant Search

Mr. Handa informed that Courtland Partners’ contract had expired and was extended to September 30, 2012. The Real Estate Subcommittee met last week to review and determine if they would keep Courtland Partners as the Real Estate consultant, or, alternatively, to go with either Cliffwater, the Board’s General Consultant, Hewitt EnnisKnupp or ORG.

The Real Estate Subcommittee decided that ORG was not acceptable to the Subcommittee, and there was a split vote as to the others, which is why the Subcommittee was bringing it to the full Board to make a determination.

Ms. Weiss said that there were two possibilities on the table. The first was to allow Cliffwater to move into the role of the Real Estate Consultant, based on information they provided when they were first hired, as well as the presentation that they made before the Board a couple of months ago. The second option was to choose between Courtland and Hewitt EnnisKnupp to be retained as a separate Real Estate consultant.

Ms. Weiss asked if there was discussion.

Ms. Pankey said that she sat on the Real Estate Subcommittee and took issue during the meeting with the fact that information about the three presenters for the September 18, 2012, Real Estate Subcommittee meeting was received ten minutes before 5:00 p.m., on the day before the meeting. Though she spoke with Mr. Foulkes regarding her concern, it was not an acceptable answer in order for them to make an intelligent decision. In reference to all committees, the information needs to be received in appropriate time to give Committee members an opportunity to formulate questions, to be properly prepared to evaluate the presenters.

Ms. Pankey expressed concern related to issues around the RFP search. She noted that there were three responses, Courtland, Hewitt and ORG, and there was a difference of opinion among the Subcommittee members on these three, but it was her position that Cliffwater did not respond. They responded to the RFP that was sent out earlier in the year regarding a General Consultant. They presented all of the qualifications, including Real Estate. The record would not show that there was a motion or action taken that stated that the Board would not send an RFP for a Real Estate Consultant to Cliffwater, and Cliffwater did not present solely on Real Estate. They did not submit a response when the RFP for Real Estate took place. She expressed her understanding of conversation with the Law Department related to whether or not they needed to respond. It was her opinion that they needed to respond. It was her opinion that there needed to be a record of the candidates that expressed an interest in doing the Real Estate piece. Since Cliffwater did not respond, she would not be considering them.

She expressed her opinion that the Board engaged in business with Cliffwater as the General Consultant, and they were still on a probationary period to determine the Board's satisfaction with them. It could be beneficial that they had the capability to do the Real Estate piece. She cautioned that the Board should be careful in making business decisions. They were looking at changing the entire Fund, which was distressed. So, for the Board to make an overall change and put all of their eggs in the basket of one consultant that was on a probation period was not good.

She questioned who would oversee Cliffwater, if, in fact, they were going to be the Real Estate consultant. She noted a comment that referenced Mr. Handa's statement that he was hired for that, and said that she did not recall from his resume that it was his area of expertise. So, she had a number of reasons why Cliffwater should not be given consideration.

Ms. Weiss asked if there were other comments or discussion.

Ms. Stukes said that she agreed entirely with Ms. Pankey, and had other issues that she brought before the Board earlier.

When Cliffwater presented their Real Estate review and analysis a couple of months ago, she asked the Board who had requested it, but no one knew. It was her opinion that it was not a presentation. If the Board had a Subcommittee, and applicants to present, then the applicants should be at the presentation to present, whether old or new. She objected to Cliffwater, as the General Consultant, being included as a Real Estate consultant. She said that to have them piecemeal their way into the situation was not fair to the Trustees and to the Fund.

Ms. Stukes expressed, from her perspective, that it was already decided when the Board hired Cliffwater that it was not going to take Courtland. If it were not, Real Estate would not have been in their contract when they were hired. The decision was already made, and the Board should have done what they had to do.

She had an issue with the requests and opinions from the Law Department being given to specific people and not everybody. She expressed frustration about asking for requests, opinions and answers to questions and not getting them. She had five of them, to which she did not receive an answer.

It was her opinion that the Law Department was crossing the bounds, and either they were going to be Trustee or Legal, but the two had to be separated. The Law Department said that Cliffwater did not have to do the RFP, and she could go with that. For the Law Department to say that Cliffwater did not have to present to the Subcommittee, she could not go with that, and wanted to know where it was written. If ethics rules were being followed, then they had to be followed, and currently, the Board was violating a lot of them.

She recalled asking if the Board had to submit an RFP, if the majority of the Board did not want to engage another separate Real Estate consultant. She was told that the Law Department said, yes. If the Board chose at the end of the contract not to do it, then why did they have to send out another RFP and waste her time and other members' time, if they knew where the vote was? There was nowhere, to her knowledge, that they had to submit another RFP for Real Estate, if the Board chose not to go in that direction, and to have it under the General Consultant, but she had not received an answer; and, they were getting ready to take a vote.

Ms. Weiss said it was her belief that it was not predetermined as to which way the Board would go, and that was why the Board wanted to do the RFP, to see what other responses they would get. They had talked for months about whether Cliffwater could or should be their overall consultant in a lot of areas, not just Real Estate. When it came to the Real Estate part of the portfolio, it was not her thought that there was a predetermined idea or consensus about which way they would go, and that was why the RFP was put out.

Ms. Stukes said for there to be a written statement in Cliffwater's contract, it was already in there, according to the information, and all they had to do was to put in the dollar amount.

Ms. Weiss said that they did not have to use it.

Ms. Stukes agreed that they did not have to use it, but noted that it was already in the contract, and she would agree to disagree that it was not predetermined. It was in writing, and she objected to that from the beginning. If the Board was doing the General Consultant, they should not have been presenting on General Consulting and Real Estate consulting. She said that when the Law Department made decisions, it should be before the Board, and based on that, she was not giving Cliffwater consideration.

Mr. Bielli asked Mr. DiFusco to address the allegations that there were ethical issues.

Mr. DiFusco said that he reviewed the contract and had it in front of him, and he had no knowledge or concerns about ethical issues. When they held the presentation with Meketa, NEPC and Cliffwater, it was all services – Real Estate, Private Equity – should the Board choose to go in that direction. His understanding was that Courtland and Cliffwater would work in conjunction on Real Estate. The contract specifically provided that in the event that the Board chose to engage only Cliffwater for Real Estate, that they would be paid an additional $30,000. It was not predetermined, which was why an RFP was issued. He was not aware of litigation risk or ethical issues if the Board chose to go in that direction.

Mr. Albert said that he agreed to disagree with Ms. Stukes' statement, because they agreed to disagree, and he did not think it was appropriate for Cliffwater to provide the presentation to the Subcommittee when they did not respond to the RFP.

Mr. Reilly noted that the Real Estate allocation was 5%, with about $165.0 million in Real Estate. He recalled Mr. Handa's report when he came on board that was showing that there was, about, $305.0 million allocated to Real Estate from the other entities. His thought was to stay with Real Estate because, Courtland did not commit the over abundance of money, $140.0 million more, into the Real Estate allocation from other entities in the Board's portfolio. His suggestion was, since they had a Real Estate consultant and Cliffwater, who oversaw everything, that Cliffwater could look at the other money that came out of their general commitment, going into Real Estate, and Cliffwater could redefine $165.0 million with the rest being where it was supposed to be, and not being put into Real Estate. He was happy with that. He was not happy with Cliffwater doing everything.

Ms. Weiss asked if there were other comments.

Ms. Pankey recalled her comment about what she believed was Cliffwater's probationary period related to the Board's September 19, 2012, Asset Allocation Study, where what was presented, she did not expect. She did not come away from the study with what she thought was the Board's perception, and that was not to have a definitive decision as to how they wanted to allocate the portfolio, but to have several scenarios to consider and why they should consider that. The Board went through half the session with a review of Cliffwater's capabilities, which they had, with a small portion as to why the Board was there. The comment was to revisit it in October, so it was pushed off, again. Her opinion was that the verdict was still out on that piece, as well. It served as their probationary period to deliver what they stated that they would deliver. She did not feel that the Board was delivered the product of a true asset allocation session or direction from their last meeting. In her opinion, it was not a star for them.

Mr. Bielli said that he did not disagree with Ms. Pankey. His thought was that less time could have been spent on marketing aspects and more time on the allocation.

Ms. Weiss asked if there were other comments.

Mr. Reilly asked Mr. Handa if they were going to be asked for more information. Mr. Handa said that Staff requested Cliffwater to provide scenarios to the Board, yesterday, and they would be providing that, hopefully, before the next Board meeting, and they had to analyze the data. It could be available by the next meeting, but, if not, then by the November Board meeting. For today's purposes, they did not provide the various areas that were requested.

Ms. Weiss requested a motion. Mr. Albert made a motion that the Board exercise the option under Cliffwater's contract, and use them as Real Estate consultant. Mr. Rice seconded. Ms. Weiss requested a vote, Mr. Reilly was opposed. Ms. Stukes was opposed. Ms. Pankey was opposed. There were no abstentions. The vote was 5-3-0, the Chair not voting. The motion passed.

Agenda Item #3 – Social Restrictions Research Provider Search

Mr. Falkowski said that Staff initiated a Miscellaneous Purchase Order for Northern Ireland and Iran restrictions research in July of 2012. The search was initiated due to the upcoming expiration of the contract with MCSI ESG. The incumbent and IW Financial responded.

After Staff engaged with both vendors, it was determined that IW Financial could not sufficiently meet the requirements set forth for Northern Ireland. Although IW Financial could match the spirit of the code related to Northern Ireland, it was unable to provide a list of companies that were not signatories to the MacBride Principles. This is a requirement specifically set forth by the City Code
MSCI ESG has been the Fund's restriction research provider for several years, and Staff has been satisfied with them. Additionally, Staff was able to negotiate a lower fee with MSCI ESG from $21,600 to $16,250. Therefore, Staff's recommendation was to continue with the incumbent, MSCI ESG.

Ms. Weiss requested a motion. Ms. O'Leary made the motion to approve Staff's recommendation. Mr. Albert seconded. The motion passed.

Agenda Item #4 – Flash Report for Period Ended August 2012

Mr. Walthour provided a market overview, with highlights on the manager and asset allocation performance, followed by the Flash Report to focus on the performance of the asset classes, as well as some of the managers within the asset classes.

Mr. Walthour provided a market commentary, saying that it appeared that investors were back into the risk markets and moved from the relative safety of Treasuries. In August, they started buying international and domestic equities, as well as risk assets within the fixed income categories of high yield and mortgages.

Mr. Walthour reported that REITS cooled a little, but had been the best performing alternative asset that Cliffwater tracked, and yields were still in the 4% to 4.5% range. The second best performing asset class within the Alternative had been the MLP index. That index was up, almost, 1.6% for the month, but, almost, 6.5% for the year. The Fund had good exposure to the MLP category but underweighted relative to the target. Had the Fund been at target, it would have been an even greater contribution from the Real Assets category in the portfolio.

The total value of the Plan was approximately $3.9 billion, with a slight overweight to U.S. Equities and a continued underweight in Non-U.S. Equities. For Fixed Income, the overweight relative to the target in July and August hurt the Fund. Real Estate was neutral. Private Equity had a great month, and the Fund was slightly overweight. Hedge Funds provided neutral contribution to the portfolio. Real Assets and MLP's did well. The Fund had a significant underweight relative to the target in MLPs, which they would address. The cash balance was at 3%.

The Flash Report was showing that there was return for the month of 1.83%, on a diversified pool of assets. Fiscal-year-to-date, the Fund returned 2.83%. Mr. Walthour indicated that although excess return was not generated versus the benchmark, being up 2.83% after two months in the fiscal year was a good start. Across the board, for the month of August, there was excess return from every category, with the exception of Fixed Income. For the month, Domestic Equity beat the benchmark by 44 basis points. Non-U.S. Equity beat the benchmark by 15 basis points. Fixed Income was under the benchmark by 11basis points. The Opportunity funds generated 45 basis points of positive relative performance. Hedge Funds generated 15 basis points of positive relative contribution. MLPs added 46 basis points of relative contribution. The Real Estate portfolio contributed 80 basis points of relative contribution. The Private Equity added close to 1% contribution relative to the benchmark. Across the board, for the month, the managers and the portfolio did well relative to their benchmarks.

Fiscal year-to-date, the Fund returned -17 basis points relative to the benchmark, with the bulk of the negative contribution coming from the Domestic Equity asset class, and within all Equity asset classes active management is struggling.

Mr. Walthour advised that the Mid Cap category had struggled and that the trailing three months generated a negative 170 basis points of relative return below the benchmark. Fiscal-year-to-date, the Mid Cap category underperformed the index by 82 basis points. Mr. Walthour indicated that at some stage the Board would need to address the question of whether or not they could find good active managers in the Mid Cap space that could justify the fees the Board was paying.

Within High Yield the portfolio struggled relative to the index, across all time periods. Active management within the High Yield portfolio would need to be addressed. Artio struggled more than McKay Shields.

The Emerging Market Debt portfolio was flat relative to the index for the month, but looking at the performance longer-term, the Board would need to think about active fees being paid, there.

Within the Opportunity funds, PFM had a strong month. FIS had a mediocre month at negative17 basis points relative to its benchmark. They managed multiple asset classes, and Cliffwater would like them to manage against one benchmark.

Most of the Hedge Funds added value during the month, with the exception of Beach Point and ESG. Both managers, particularly ESG had strong performance since inception, beating the benchmark by, almost, 10%. Beach Point struggled which relates to the timing that the investment was made. They had a strong track record, with a strong conviction in what they were doing for the portfolio.

The Independence Fund, was beating the HFRX Event Driven Index across all time periods and that was good news for the internally managed program.

Cliffwater had concerns about the two Hedge Fund managers, Karsch and Mason. Mr. Walthour indicated that Karsch was known as a more defensive manager, and did better than their peer group when other managers were not doing as well. Cliffwater would like to see more consistent, positive performance with Karsch. Mason struggled with a large portfolio. Mr. Walthour indicated a concern that the portfolio might be too large. They struggled with a number of their sovereign debt situations. There was no consideration about putting them on the watch list or terminating them, but there was some concern about their ability to turn the portfolio around, given how big it was.

Ms. Pankey asked Mr. Walthour to provide the managers that were on watch. He named AJO, Emerald, Lee Munder, Artio and Trilogy. She asked if there was a recommendation to upgrade or downgrade them. He said to leave them where they were. There was a search underway in High Yield and in Emerging Markets. So, all of the steps were being taken to replace the managers if they did not turn around. A Small Cap Value search had been done. It was his thought that action was being taken.

Agenda Item #5 – Flash Report for Opportunity Fund Managers for the Period ended August 2012

Ms. Cherry reported split performance for the Opportunity Fund in August, where PFM outperformed by 56 basis points and FIS underperformed.

For FIS, three managers underperformed. Their purpose in the portfolio was to provide downside protection. They were not expected to perform well in an up market. Martin Investment Management underperformed by -83 basis points. Two more notable laggards were Edgar Lomax where relative underperformance was due to an underweight of high beta stocks, and the higher beta stocks performed well, and, also an underweight to stocks with low or zero dividends. Herndon International underperformed for similar reasons. Geographically, they underweighted Japan and China, and those regions did not perform well.

FIS terminated INVIEW from the portfolio. It was not performance related. The firm was not able to grow assets, and they made a decision to either merge with another firm or close at the end of the year, and one of the founders left the firm, effective in September. FIS decided to terminate the manager and replace them with Elessar Investment Management, who has a similar strategy to INVIEW. They are an Emerging firm, which is the qualification. They are based in Cleveland. FIS will be updating the Board on sub manager status changes at the quarter end

PFM overall outperformed. There were three that underperformed Marvista, and two International, Cheswold Lane and Herndon International. Herndon was the same fund as with FIS. For Marvista, Coca Cola was the largest detractor from relative performance. Cheswold Lane underweighted utilities and telecommunications, which detracted from their relative performance.

Agenda Item #6 – Chief Investment Officer's Report

Mr. Handa noted Securities Lending income had been fairly consistent since hiring JP Morgan. He said that it was expected, and, as. Mr. Walthour stated earlier, there were Hedge Funds that would short, and it was good that they had the program in place.

He reported Quality "D" interest rates at zero, and that a few months ago it was close to, about - $2.0 million, and was now at -$1.4 million. So, there were benefits to a low yield environment.

The breakout of the Philadelphia/ Suburban and Diversity Managers was included in the Board binders.

The updated Board calendars for the next Board meetings are listed as October 25, 2012, November 29, 2012, and December 20, 2012.

Ms. Weiss asked if there were any other matters or new material for the Investment Committee.

At 10:30 a.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 10:34 a.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. Stagliano made the motion. Ms. Cornell seconded. The motion passed.

At 10:34 a.m., Ms. Weiss requested a motion to adjourn the Board of Pensions and Retirement Meeting. Mr. Stagliano made the motion. Ms. Cornell 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