

**BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
OCTOBER 25, 2012**

MEETING MINUTES

There being a quorum, the Investment Committee Meeting was called to order at 10:06 a.m. in the Board's Conference Room, Two Penn Center Plaza, by Paula Weiss, Esquire, Alternate Board Chair.

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, Deputy Director of Human Resources
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
Olanipekun-Lewis Folasade, 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, Law Department
Katherine Mastrobuoni, Esquire, Law Department
Ellen Berkowitz, Esquire, Law Department
Arlene Sawyer, Investments
Carmen Heyward, Investments
Donna Darby, Investments

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Stephen Nesbitt, Cliffwater
Jacob Walthour, Cliffwater
William Rubin, Deputy Director, City Comptroller's Office
Will Greene, Loop Capital
Robert O' Donnell, O'Donnell Associates
Chester Skaziak, Retiree, Firefighter
Andrew Thomas, Local #22, Firefighter
Pam McCue
Kyle Myers

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Mr. Dubow opened the meeting by announcing Mr. John Reilly's last full Board meeting after thirty-six years. Ms. King presented Mr. Reilly with a citation from the Council of the City of Philadelphia recognizing and honoring John A. Reilly. Ms. King stated The Council of the City of Philadelphia is pleased and proud to extend its sincere congratulations to John A. (Moon) Reilly upon his retirement following thirty-six years of faithful service as a member of the City of Philadelphia Board of Pensions and Retirement.

Agenda Item #1 - Approval of Minutes of September 19 and September 25, 2012

Mr. Dubow said that the first order of business was the approval of the minutes of September 19, 2012.

Mr. Dubow requested approval of the Minutes for September 19, 2012. Mr. Stagliano made the motion to approve the September 19, 2012 Minutes. Mr. Reilly seconded it. There was no discussion. All were in favor. There were no oppositions or abstentions. The motion passed.

Ms. McNavish informed Mr. Dubow that the minutes for September 25th are also in the folder and that there were no substantive changes.

Mr. Dubow requested approval of the Minutes for September 25, 2012. Mr. Albert made the motion to approve the September 25, 2012 Minutes. Ms. Stukes seconded it. There was no discussion. All were in favor. There were no oppositions or abstentions. The motion passed.

Agenda Item #2 – Asset Allocation Recommendation

Mr. Nesbitt stated that Cliffwater's purpose was to recommend an asset allocation. In September, Cliffwater held an education session where they discussed asset allocation, the asset allocation process, what other retirement systems are doing in terms of asset allocation, the Plan's specific circumstances, and other options for asset allocations. Mr. Nesbitt stated Cliffwater's purpose was to recommend a specific asset allocation and an implementation plan. In a handout distributed by Cliffwater, Mr. Nesbitt said there are four asset allocations listed in your current policy and your current actual allocation. Mr. Nesbitt said Cliffwater's focus will be on the two policies presented today and then their job will be to implement the actual allocation to get it close to the selected policy.

Cliffwater was recommending policy A. Based on some questions at the workshop, Cliffwater also put together a policy B as an option. The difference between the two policies is that policy B was designed to provide a target rate of return equal to the Plan's actuarial interest rate assumption of 8.1%. Mr. Nesbitt stated that from a policy perspective the target does not need

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to be exactly at the actuarial interest rate. It has been his experience that if you're close to the target rate, as long as you're in the ballpark, it doesn't require a change in assumption or the actuarial amount.

Mr. Butkovitz asked Mr. Nesbitt what the recommended allocation does to the risk of a significant loss in any given year. Mr. Butkovitz said he's still scarred by the 2008 and 2009 experience where substantial increases in contributions were triggered by a one year downturn. He asked Mr. Nesbitt if this is eliminated anywhere in this plan and which factors drive that risk and to what level.

Mr. Nesbitt said Mr. Butkovitz is identifying two types of risk. There is asset risk or volatility and then there is contribution risk. He said the Cliffwater proposal does not eliminate a 2008 type of occurrence. In terms of volatility, the existing allocation policy return expectation is 7.71% and the standard deviation with the current allocation is expected to generate 12% volatility. That means assets could fall 20%. Cliffwater's recommended policy expects a slightly higher level of return, 7.92%. The level of volatility is anticipated to be 12.40%, roughly the same as the current policy. This portfolio is potentially subject to a 20% drawdown. Mr. Butkovitz asked Mr. Nesbitt if this was based on volatility. Mr. Nesbitt's response was yes. Mr. Dubow wanted to know if 2008 and 2009 are outside of the expected risk. Mr. Nesbitt said the litmus test is a two standard deviation and a stress test, worse case, is a two standard deviation. Mr. Dubow wanted to know if 2008 and 2009 was within two standard deviations and stated this is probably not the worse case. Mr. Nesbitt said 2008 was more of a three standard deviation event. He said most investment professionals attribute it as a once in a century event, however there is no guarantee that they are correct in this estimate.

Mr. Dubow asked Mr. Nesbitt if Cliffwater could provide a portfolio mix that essentially eliminates that risk. Mr. Nesbitt said they could but they could not come close to the Plan's 8.1% expected return. He said the only asset classes that will get you above the actuarial interest rate of 8.1% are generally private investments and that these types of strategies can be risky. They're illiquid, they can be volatile, but they have historically provided a high level of return. The only asset classes that will protect you from a 2008 type of occurrence are what are known as risk off assets. These types of assets typically have an expected return range between 2% to 3%. Mr. Nesbitt said we could give a recommendation that virtually eliminates a 2008 type of occurrence but the Plan's total return is only going to be 2% to 3%.

Mr. Bielli inquired about achieving an 8.1% expected return which requires a high allocation to risk on assets (Cliffwater's Long Term Expected Returns) and the projected return of 8.13%, with risk at 11.80%. (Efficient Frontiers at Various Alternative Allocations). Mr. Bielli said there

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are a large percentage of Alternatives, however, the return is 8.13% and the risk is actually lower than the risk that Cliffwater's currently recommending to the Board and he wanted to know how Mr. Nesbitt justifies the two statements and the numbers that are associated with it.

Mr. Nesbitt explained one has to do with strategy; the other has to do with implementation. He said the second policy B, where they talked about implementation; they expect an 8.1% return. The volatility is much higher and we could go to policy B if you're willing to except an implementation plan that involves the use of Hedge Funds within the long-only Asset Classes. Cliffwater's allocation strategy can get the volatility down but that's an implementation issue.

Mr. Walthour said that based on the policy Cliffwater is modeling based on expected returns and risks for an overall asset class. He said you're seeing similar volatility to the current asset allocation plan but once we bring in the implementation, for example, if we add long-short to the Equity portion of the portfolio the fact that there's now a short portion to that portfolio will dampen the volatility within the Equity portion of the portfolio. He said within credit, right now you're 100% long-only in Fixed Income, by adding alternative credit managers that can go both long and short the market, you're going to bring down the volatility within the Fixed Income portion of the portfolio.

Mr. Bielli said you're telling the Board that Cliffwater's recommending an asset allocation; however, the implementation of that allocation will affect the result of numbers that we're putting in. Mr. Walthour responded absolutely, we would hope that through manager selection we're able to do better than the 7.92% if we pick managers that could actually outperform their benchmarks, likewise, we would expect some managers to be volatility damping and they would help bring down the overall risk.

Mr. Dubow said when you came into your presentation, originally, Cliffwater seemed fairly confident they could get to the 8.1% but now the recommendation is actually below that. He wanted to know if there had been a change in the market, what happened, and why is it lower.

Mr. Nesbitt explained interest rates have come down, even further. He said the positive is we've had a reasonably good year but the negative is that expected returns have come down because most of the positive return is the result of higher P/E ratios on the equity side and lower interest rates on the bottom side. Mr. Dubow asked Mr. Nesbitt if he expected those lower rates to continue.

Mr. Nesbitt said generally embedded in the market expectations are slightly increasing rates in the longer term, so if anything, there may be higher interest rates but the offset will be lower

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returns. Interest rates go up while returns go down. Mr. Nesbitt spoke on the incremental changes versus the equity allocation. He said your current policy is 42% Equities, while our recommendation is 40% Equities and, based on our models, we can get to 8.1% by staying at 40%. Mr. Nesbitt stated they are reducing Equities because Equities are very volatile and to some extent we're reducing the volatility of the portfolio by reducing Equities. We're also reducing Fixed Income because that's a lower return, currently its 26% of the asset allocation. Our recommendation is 23% Fixed Income. In the case of the 8.1% target we would go down to 21% in Fixed Income. To increase that return we've got to shave more off the Fixed Income allocation. He said probably, more importantly is the allocation of Private Markets investments in Private Equity and Private Debt. These Risk-on assets are one of the few asset classes that have generated returns above the 8.1% target and that these types of investments would need to be increased. The current policy target is 13% of Plan assets, our recommendation under Policy A is 15% of Plan assets which is a 2% increment. To achieve an 8.1% overall return based on Cliffwater's models, the Private Markets allocation would need to increase an additional 2% for a 17% target allocation. Mr. Dubow asked Mr. Nesbitt what does that level of increase do to volatility. Mr. Nesbitt said it is about the same. Mr. Nesbitt explained there's not a lot of change in volatility. He said the Plan's illiquidity increases because with Private Equity type structures, there is typically a 5 to 10 year lockup period and so in terms of cash flow it's not an investment with a lot of cash flow. Mr. Dubow asked if that's the big difference between the recommended Policies is the level of liquidity. Mr. Nesbitt said yes. The percent of illiquid is 19% to 21%. Mr. Nesbitt stated Cliffwater's position is that we recommend policy A and we do not have a problem with policy B. He said the return to risk ratio is the same, it's really a liquidity issue.

Mr. Dubow inquired about there being a liquidity danger zone. He wanted to know if being above a certain percent in illiquid securities would be a real concern. Mr. Nesbitt said that's a function of the Plan's cash flow circumstances.

Mr. Stagliano asked Mr. Handa if that small difference in liquidity is a problem.

Mr. Handa responded that Staff is supportive of both policy A and policy B and think both are good ideas. He said in terms of implementation, because of the cash flow distributions Staff is trying to create, and although they might be labeled as illiquid assets, the Plan will be getting a lot of cash distributions from Managers on an annual and quarterly basis even though the assets are tied up for what seems like a long period of time. He stated that with the help of Law, Staff has been able to structure certain contracts, case in point, KKR and Beachpoint, specifically where the Plan can get quarterly and annual distributions from our Managers

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before they get compensated. Mr. Handa wants the Board to be aware of these things. He said both proposed Policies are very good in terms of asset allocation.

Mr. Dubow asked Mr. Nesbitt would there be an impact on the difference between the two, on liquidity based on the way Mr. Handa is structuring Manager distributions.

Mr. Nesbitt said it's Staff that has to be under liquidity constraints over the course of a year. He said what he's seen in terms of Staff's negotiation is that they put a premium on liquidity and they are able to make relatively illiquid investments more liquid. He said there is no reason for Cliffwater to believe that the 8.1% as proposed in Policy B will not work for you.

Ms. Stukes wanted to know why the Board would knowingly go with an asset allocation below the Plan's assumed rate of return. Mr. Dubow and Mr. Stagliano agreed. Mr. Dubow stated we're trying to figure out how illiquid is that 17% targeted for Private Markets. Mr. Butkovitz stated we would be happier with a debate between what would usually happen and what could happen. He said that's the problem he's having. Mr. Butkovitz said Cliffwater's statistics indicate for the most part we would do pretty well under Policy B, but he's worried about the possibility of a twice in a century downturn event.

Mr. Handa replied it's safe to say we will continually have issues of the foreseeable future. In 2000 we had technology bubble, in 2001 we had 911, then the 2008 financial crisis happened, and in the last 2 ½ years we've seen a similar situation occur in Europe. He stated we will always live in uncertain times.

Mr. Leonard asked Mr. Handa if the distribution strategies Staff is pursuing with Managers going to be enough to mitigate the increased pressure on cash flow if he goes with policy B. He wanted to know if Mr. Handa is confident about this approach.

Mr. Handa said he couldn't guarantee anything but he believes that it does mitigate a lot of the risks associated with illiquid assets. He said he would like to believe that with the two examples and investments that we've made our lives easier. Mr. Handa stated he believes there is enough in the pipeline that Staff hopes to bring to the Board for approval that will show greater distributions from our Managers going forward.

Mr. Leonard asked Mr. Handa if he thinks the Managers will be agreeable to these types of terms. Mr. Handa said there are several managers who are not only agreeing but are happy to be more generous than the current investments that we have, however, we're still in the beginning stages with them, nothing has been finalized. Mr. Walthour added you're probably not going to have a problem structuring managed accounts with managers in this environment.

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Mr. Butkovitz inquired about the European banking crisis going toxic and wanted to know if liquidity will be king at that point.

Mr. Nesbitt responded that would represent a significant opportunity for many of the private investors and said there's a positive to that. He stated the question is whether we're looking at the Fiscal Cliff or the collapse of the Euro. What will happen to the value of our existing investments?

Mr. Butkovitz said there will likely be less money in circulation.

Mr. Walthour said liquidity's always king in a down market but what we're trying to do is implement an asset allocation. Mr. Butkovitz said we would have to pay pensioners in money. Mr. Nesbitt and Mr. Walthour stated that is correct. Mr. Butkovitz wanted to know how this would be done. Mr. Dubow responded in terms of moving money, flexible.

Mr. Nesbitt noted unlike your current policy, we made a 2% designated allocation in cash. Staff had Cliffwater put an actual reserve in, we have liquidity there. We have liquidity in Fixed Income and Equity. There's plenty of money there to pay benefits. He said the problem with a significant drawdown, whether it's a Fiscal Cliff drawdown or it's a Euro drawdown is the Plan would become unbalanced in terms of the asset allocation because you cannot all of a sudden move money, if assets go down 20%, then the Private Market Investments will become a larger fraction of the overall total portfolio mix, and it would be difficult to rebalance. Mr. Nesbitt thinks that Mr. Handa's implementation strategy of providing an option for current cash flow allows for greater flexibility. This would likely mitigate the effects of a downturn and the Plan would be unlikely to face a severe liquidity crisis like many of the endowments that got jammed up in 2008 when they really could not rebalance their portfolios. Mr. Butkovitz asked Mr. Handa for his response to his question.

Mr. Handa said crises always occur. If we're down 25% will we have liquidity meet our obligations? The answer is, yes we will. Mr. Handa said there's cash available from our equity book, there's money available from our fixed income book to meet our obligations. The cash is available. Additionally, what we always do every month is reserve for those situations. We always have at least \$80 million in cash in order to pay benefit obligations. It's always available. Those obligations will always be met on a monthly basis.

Mr. Nesbitt said the difference between policy A and policy B is the illiquid portion of total assets increase by 1% with policy A and increase by 3% under policy B. Mr. Dubow said it sounds like the implementation strategy would be different so while the percent looks different

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the actual impact on liquidity may be different. Mr. Nesbitt said basically Mr. Handa's strategy is a mitigating factor.

Ms. Stukes asked Mr. Nesbitt what type of products the Plan is going to have in Private Debt. Mr. Nesbitt responded it ranges but generally these are partnership investments, just like Private Equity. Instead of investing in Equity Securities they invest in Debt Securities of corporations. He said this is a sub-asset class that is growing because of the crisis in the banking system where small banks and medium size banks are not lending to businesses. That has increased the opportunity for other private capital and non-financial capital to move in and earn above average returns. Mr. Nesbitt said he would imagine that Mr. Handa has already started implementing these strategies to take advantage of the capital gap that the financial crisis has created.

Mr. Handa reminded everyone that one of the things that Staff likes about both of these policy recommendations is the flexibility that Cliffwater offers and that it gives the Board a range. He said it doesn't mean that just because you put down 49% into illiquid that means we are locked into 49% for illiquid strategies. We don't have to be at 49% or have that much in illiquid assets.

Mr. Dubow noted a shift from Fixed Income to Private Investment and a \$40 million shift from Public REITS to MLPs. He wanted to know if this was the two big differences between them. Mr. Nesbitt answered correct.

Mr. Walthour added that as Private Investments are brought to the table for approval, we can have a liquidity check right before the Board approves to make sure that you're comfortable with where Cliffwater stands from liquidity standpoint.

Mr. Nesbitt added it's not uncommon today to do a liquidity schedule. You're projected out 18 to 24 months, as fiduciaries you can see what projected cash inflows are and what projected outflows are, and to make sure you're not using up your liquidity.

Mr. Dubow inquired about how often we should take a look at this and see if we need to rebalance it. Mr. Nesbitt said you should review every three years unless something significant happens. Several Cliffwater clients look at it every year. Since 2008, many of our clients review this every year. Mr. Nesbitt said whether you go to policy A or policy B that's only 50% of the answer, the other 50% is implementation. He stated you have the implementation gap right now and part of this is stepping that up. The standard consultant answer is every three years. The real answer is a review every year.

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Ms. Pankey asked Mr. Nesbitt if the 2% cash that Cliffwater's recommending is above what we are currently holding. Mr. Nesbitt replied 2%, is roughly \$80 million dollars and that reflects what you're currently holding. He said your current policy is to hold no cash and you are holding cash. We're acknowledging that as a part of the policy because cash is expected to generate close to a 0% return and that impacts the asset allocation calculation.

Mr. Leonard said he recalled comments from Staff at different points last year when they talked about the Private Equity book having too many positions. He said he's wondering if we are adding money, are we also adding more positions or are we looking at consolidating?

Mr. Handa said that we have a lot of positions in Private Equity, many of them are small positions and many of those positions will be coming off in the next two years, so there's a time horizon for them. What Policy A and B does is account for those positions coming off. He said he believes the Board prefers that we have fewer positions on and so we are writing larger tickets and have been over the last 16-17 months, on average they have been for \$30 to \$50 million. This will make the positions chunkier and you will receive more cash distributions. He said we are trying to mitigate that J-curve effect that we are accustomed to seeing with a lot of the Private Equity vehicles where you wait five years and then get paid off. We can't afford to wait because of our mature status as a plan. What we're trying to do is construct these Private Equity vehicles and Hedge Fund vehicles so that we get distributions literally, within the first year if not sooner. Mr. Handa stated the way he thinks about this is that we are landlords renting our cash to managers. They have to pay a premium back and if they don't pay it back, a decision will have to be made on whether to keep them or not.

Mr. Dubow noted based on the change it looks like we would stay at the same amount we have now, above the current policy. He said the amount we have in Private Equity is above our policy. It looks like we'd stay at about \$560 million. The big difference now is we're on the Private Debt side. We don't have anything, we go to \$120 million. Mr. Nesbitt said yes and the reduction in Public Debt which is we're going from earning 2% to 3% to earning around 6% to 7%.

Ms. Stukes went back to Mr. Leonard's question. She stated at the May or June Meeting there was a discussion about Private Equity. During this meeting Mr. Bielli and Mr. Butkovitz asked the question, did Staff plan to increase the level of participation with Private Equity, the answer was yes and now she is hearing no. She said the debate was about increasing the allocation of Private Equity because the issue was that not a lot was taking place in Private Equity. Ms. Stukes stated she thought when the question was asked to Mr. Handa about increasing the

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allocation of Private Equity he replied yes and now the answer is no. Ms. Stukes said she was confused.

Mr. Handa's responded that his understanding of the question was, are we going to increase the Plan's exposures to Private Equity? The answer was going to be dependent on the review of the asset allocation review and that is why the question was answered that way at that time. He stated the way that we're structuring a lot of these deals going forward, they may be considered Private Equity, Hedge Funds, or long-only strategies, we're trying to get as much cash flow from these positions as quickly as possible, even if they are considered a five to seven year vehicle. You won't wait three or four years to get the distributions back. You're going to get the distributions back very quickly, that's why we're renting capital the way we are. Mr. Bielli stated he thinks he does remember, he thinks the answer was yes because current Private Equity positions are going to start falling off.

Mr. Nesbitt spoke about the implementation plan that Cliffwater would recommend. He said there would be passive management in some asset classes, traditional active management in some asset classes, and Alternatives. Alternatives could be a Private Equity structure but mostly this refers to Hedge Fund structures. The recommendation is for 12% to be allocated to Hedge Funds; Cliffwater recommend all of that being in Hedge Funds because that's the designated asset class. Emerging Markets is 7%; we recommend 0% in passive, 4% in traditional active. Normally we don't have traditional active, this could be a bucket that takes in the Opportunity Funds, and we allocate part of that to this category and then 3% in Alternative which would probably be an Emerging Market Hedge Fund. Mr. Nesbitt said if we do indexing or traditional active the Alternatives would be 33%. He said we could go up to 49% in Alternatives when it's fully implemented if we used Hedge Fund structures or long-short strategies within the long-only Asset Classes.

Mr. Dubow asked Mr. Nesbitt if that's where we will end up or could end up if we were at the top of the range. Mr. Nesbitt replied that it would be at the top of the range if you maxed out. Mr. Dubow asked Mr. Nesbitt if it would be somewhere between 33% and 49%. Mr. Nesbitt responded that Policy A is targeted for 33% in Alternatives. He said there's 33% embedded in the asset allocation. There's a possibility you could go up to 49% if you went in entirely into long-short structures. Mr. Nesbitt said approval of the asset allocation that we're recommending; we're excepting 33% in Alternatives. To go above that you would have to approve that on a case by case basis.

Ms. Stukes said that this seems dangerous and if we want to make an analogy, go back to where the Plan was when there was an over-commitment to Real Estate strategies and it seems

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as if we're doing the same thing right now with Hedge Funds and that seems like an issue. Mr. Dubow said we don't want to go up to 49% in Alternatives. Ms. Stukes said that 33% in Alternatives, it a lot and that's her position. Mr. Nesbitt said you're not approving 49% today as he sees it, you're approving 33%. Ms. Stukes stated it is still a lot and she wants it to go on the record for everyone to know, it is not just 12% Hedge Fund in this Fund, it is similar to 33% which is a lot. Mr. Nesbitt said the industry average right now for those that invest in Alternatives is about 25%; they are relative to everybody else. Ms. Stukes said we're above that. Mr. Nebitt said you're about 8% above. Ms. Stukes responded we're above 8% if you consider the option to go to 49%.

Mr. Dubow asked Mr. Nesbitt does that increase their risk. Mr. Nesbitt said no, not necessarily. He said if you're overweight in Alternatives, particularly in Hedge Funds, they're generally lower risk than what the Plan is underweight in Public Equities, it's lower risk in terms of volatility.

Ms. Stukes asked Mr. Nesbitt if Cliffwater's benchmark for Hedge Funds is the Fund of Hedge Funds benchmark. Mr. Nesbitt responded yes. Ms. Stukes asked if that was the correct benchmark even though the Plan doesn't have any Fund of Hedge Funds. Mr. Nesbitt replied that it is the common industry standard.

Mr. Nesbitt summarized that 8.1% is a difficult target to meet. He said you have to take some risks and if you want to use conventional asset classes and products like you have in the Plan's Deferred Compensation Plan the best any consultant can do for you is something between a 6% to 6 ½% Total Plan return. To reach a target you have a long term time frame. Cliffwater believes, and most of the industry believes, that the higher returns are in Alternatives. We've recommended that whether you go with policy A or policy B it's a plan that puts you close to a third of the portfolio in Alternatives. In terms of implementation, there's a lot of work to be done. He said he thinks that Mr. Handa has a very good strategy in terms of combining return with cash flow. He believes that in some of these asset classes there's some work to do in terms of implementation and whether you do policy A or policy B it gets you on a path that you need to get on to have a reasonable chance of earning your return assumption. He thinks both asset allocations meet industry best practices in terms of diversification. You've got a somewhat greater incline than the average fund out there.

Mr. Stagliano made a motion to adopt asset allocation Plan B. Mr. Albert seconded it. All were in favor. There were no oppositions or abstentions.

Ms. Stukes said she will agree that they closely monitor the Hedge Fund allocation because she is really concerned about it. She said Hedge Funds are not doing great these days and

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that she will agree to the motion provided that there is a close watch on the Hedge Funds. Mr. Dubow asked if everyone voted yes. The vote is unanimous. The motion passed.

Agenda Item #3 – Cash Proceeds Recommendation

Mr. Handa stated that the Plan received \$294,241,226 last week, \$230,000,000 from a bond offering, \$6,043,226 from accrued interest, and \$58,198,000 from the State, that the Plan is holding until we implement the asset allocation which was just approved by the Board. Mr. Handa said we need to put out an RFP to do another passive manager search and that is why Staff recommends at this time that we use the proceeds in the following manner, \$53 million set aside to pay benefits for the coming month, then the balance split between the S&P 500 Index and the Core Bond Fund. Staff also had conversations with Cliffwater and Steven Jacob; they are also in agreement with this. The cash is sitting in the operating account with the additional \$80 million cushion set aside as part of the approved asset allocation study. Mr. Handa thinks it's about \$380 million or so sitting there as of this moment. Until the Board approves how to implement the dollars, the cash will remain in the operating account.

Ms. Pankey asked Mr. Walthour if there was another option. Mr. Walthour said in light of the fact they were going through the whole process of an asset allocation, this made the most sense. Ms. Stukes asked Mr. Handa if J.P. Morgan offered another alternative for us to put our money in. Mr. Handa said they called J.P. Morgan yesterday and spoke to them. They don't currently offer a passive index vehicle or a passive index Manager, they only have active Managers. Ms. McNavish added that the cash is earning 13 basis points in a JP Prime Money Market Fund. Ms. Stukes wanted to know if we could leave it there. Mr. Handa said yes.

Ms. Stukes asked Mr. Handa what the interest in the index is. Mr. Handa said the S&P 500 Index can move up and down. Coming in today the S&P is down 2.2% this month. He said there are no guarantees on what return you're going to achieve on the S&P 500 Index, however, considering our mature status, the funding levels, and that we are long-term investors we have to invest these dollars. Mr. Bielli added the S&P 500 Index does have a dividend which is around 2.9%, it's not an interest rate, it's a dividend. Mr. Handa said that is correct. It's an annual dividend and people do seem to love the interest more than the principle. Mr. Dubow asked Mr. Handa does he have a sense of how long we will stay in the index and would it be a few months. Mr. Handa confirmed it would be a few months.

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Mr. Stagliano made a motion that we implement staff's recommendation to approve adding the capital to the Rhumblin S&P 500 Index. Mr. Reilly seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

Mr. Handa said he would like, if possible, an RFP put out for another passive manager search.

Ms. Stukes made a motion to put another RFP out for a passive manager search. Mr. Reilly seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

Agenda Item #4 – Small Cap Value RFP Recommendation

Mr. Falkowski reported that in November 2011 Staff had issued an RFP for a Small Cap Value Manager. This was due to the contract expiration of Fisher Investments. Fisher Investments was rehired in May. In June, the Board voted to replace Lee Munder Capital Group with NewSouth Capital Management. Contract negotiations failed between Staff and NewSouth Capital Management, and as a result, Staff is recommending hiring Snyder Capital Management which was a finalist for the search. Mr. Falkowski said Staff was very impressed with Snyder and he believes the Subcommittee was also.

Mr. Dubow asked Mr. Falkowski what would be the other option?

Mr. Handa said they can issue a new RFP and look for a new manager, and put it into a passive index fund in the interim, or not do anything and leave it in the index fund permanently and not have to worry about having exposure.

Mr. Bielli asked Mr. Handa if they could look into that possibility for the long term as these situations come up when the Board votes to terminate a manager. He said it's very difficult to see the money sitting with a manager who has been terminated while contract negotiations with the other manager are ongoing. He added that contract negotiations with NewSouth have failed through no fault of the City's since that company did not agree to certain things that are crucial to having the City charter or the City code. Mr. Handa said that's a policy decision and the policy will have to be changed. He said he believes there have been conversations with legal about this and it's something the Board will have to approve of going forward. Ms. Stukes asked Mr. Handa if this is a policy that the money has to stay with the manager. Mr. Handa said it has not been a policy, and if the Board would like it to be a policy we can make it a policy. Mr. Bielli said we can make it a policy because if it happens it becomes automatic, however, in this case, the money's going to continue to sit with Lee Munder Capital Group unless the Board makes a decision to move it out of Lee Munder Capital Group. Mr. Leonard said that from a

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legal standpoint he does not have a legal name to keep the money with the manager once we terminate the contract. Ms. Weiss stated that in the past we've made it on a case by case basis decision when we've terminated the manager to move the money somewhere while we were doing the search.

Ms. Stukes said the issue was the cost to the Board or to the Fund of firing the manager, putting the money in an Index Fund, looking for another manager, going back out and giving those assets to a new manager. Ms. McNavish said if you're going into an index fund and then putting money into the new active manager, you're performing two transactions. Ms. Stukes said this was one of the reasons we decided to leave the money with the manager. She said it has never taken this long to get a manager and this is the problem we're having, getting a manager.

Mr. Walthour commented that Cliffwater has spoken to Staff about this and there might need to be a policy decision. He said they do not think it's wise and certainly recommend to the Board that they consider this in the case of Lee Munder Capital Group, given their performance. This allows Staff to terminate the relationship and transition the monies into an index surrogate. He said the performance continues to deteriorate to the point where you're now 4 percentage points behind the benchmark since inception and that far out weighs the cost associated with transitioning the portfolio to an index and then from an index to an active manager. A portion of the stocks that are sitting in the Lee Munder Capital Group account are going to be in the index and then when the index is unwound, a portion of those stocks are probably going to be desirable by the next manager. Therefore, you're not going to experience a round trip transaction on all those securities in the portfolio. It'll be some portion of the portfolio, but at this stage you're paying active manager fees to someone whose losing a percent a month, relative to the index. There's no telling when the next contract will be signed. Contracts could break down again.

Ms. Stukes made a motion to hire Snyder Capital Management. Mr. Stagliano seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

Agenda Item #5 – Flash Report for the Period Ending September 2012

Mr. Walthour reported that September happened to be a risk-on month with a very solid set of gains in risk assets both on the equity side and the fixed income side, with those rallies primarily accompanying announcements out of Europe that collectively European governments are prepared to do, whatever they need to do to stop Europe from repeating the crisis that we've had here in the U.S. At the same time the Fed in the U.S. announce an unlimited bond

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buying exercise where they'll continue to buy particular mortgage securities to support the market. He said he thinks a lot of the macro risk has been taken off the table in the minds of investors and they're moving away from investing in investment grade securities that are considered safe havens during times of stress and moving instead into lower credit securities in markets considered to be riskier. He said Cliffwater doesn't necessarily think this trend is sustainable because there are substantial fiscal imbalances and there will be individual scenarios at the corporate and government level that will likely bring investors back to a risk-off environment. The month of September was a very positive month.

Mr. Walthour reported the Russell 3000 went up over 2½%, international stocks over 3%, and Barclays High Yield was up over 1% which is a very strong month for High Yield. Some of the other assets, particularly investment grade Fixed Income, as shown by the Barclays aggregate, has done fairly well. He said in a risk-on environment people are focusing on those things that were beaten up the most in the market.

Emerging Markets outperformed Developed Markets. Asia outperformed Developed Markets. Europe outperformed the U.S. Small Cap stocks which are considered to be riskier outperformed Large Cap stocks in the U.S. He said volatility continues to decline and is near all time lows which is likely a result of investor's perception of market direction. This month there has been a brief spike in volatility primarily due to corporate earnings; from a macro perspective, last month people felt volatility was rightfully in its place near all time lows. Emerging Markets Bonds and High Yield were the best performing asset classes within the credit space as investment grade was sold and non-investment grade was purchased. He stated it's been a record year for high yield issuance and it was a record month during the month of September for high yield issuance. People are embracing High Yield Securities as being relatively safe and also a good place to make money, it seems to represent investors desire to move away from Treasuries where they're earning under 2% and rotating into High Yield where they can earn 4 ½% to 6% or potentially 7%. He said within Alternatives, as expected, during strong months for Indices, particularly long-only Indices whether they be Credit Indices or Equity Indices, the hedged-nature of the Alternative portfolios are going to underperform. Cliffwater's expectation is that Hedge Funds should try and capture 60% to 70% of the upside and only capture 40% of the downside. In an environment like September, Hedge Funds captured almost 2/3's of the upside. Equity long-short was the best performing category of Hedge Funds. The worst performing category of Hedge Funds was the macro space. Macro Managers are Managers who focus on Global Macro Economics. He thinks they still see reasons for concern and have their portfolios bearishly positioned in a month where it would have paid

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to be bullish on risk markets. MLP's continue to do well. They have equity like returns but they continue to be one of the highest yielding securities in the liquid markets around the world. REIT's sold off. However, REITS are still offering a, very compelling yield. The year to date performance is up 14 1/2 %.

He said assets that did underperform were assets that essentially didn't contribute as much return as other assets. Virtually no one lost money during the month of September and the best performers were the Equity managers. Hedge Funds contributed the least during the month but they made contributions relative to their Indices.

He said the Total Fund outperformed the policy benchmark by 24 basis points and achieved outperformance relative to the benchmark in six out the eight broad asset allocation categories. Domestic Equity managers struggled to outperform their benchmarks, there was a negative contribution from an implementation standpoint. Fixed Income managers continue to do well relative to their benchmarks and they made a strong contribution. EAFE managers also made a strong contribution from stock selection. He said the area that didn't outperform its benchmark was Emerging Markets but as an asset class it was still up 5%, so its contribution to the Total Plan was quite positive. Some of the managers underperformed their benchmarks but not to the extent that that we're concerned overall. All of the Alternative categories outperformed their benchmarks, Real Estate, Private Equity and Hedge Funds. Hedge Funds didn't contribute a lot to the bottom line during the month as everyone within the hedge fund category for the most part was contributing relative to their index. The Fund's relative underweight to Real Assets, didn't contribute as much as possible to performance as MLP's have done extremely well throughout the year, including during September.

Ms. Pankey thanked Mr. Walthour for the Watch List she asked for.

Mr. Bielli noted that in conjunction with Cliffwater and Rhonda, Staff is working on revising the Watch, Probation guidelines.

Mr. Walthour thanked everyone for approving the asset allocation and implementation plan. He stated Cliffwater has been working on policies and procedures with Staff and Law and also looking at the current Watch List format. He thinks that what Cliffwater plans to do is proceed with all deliberate speed on implementation. He said Staff has been identifying a lot of managers, and Cliffwater has been identifying a lot managers as well. We think we have a

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good structure in terms of implementation. When you have a significant change in asset allocations, policies and procedures have to be updated.

Mr. Walthour said Cliffwater would like to try and tinker with quarterly meetings, a watch list and monitoring program that they currently have in place. He said Cliffwater would like to get to a point where those quarterly meetings are focused on the problems, not necessarily cheerleading for everybody that's done well but maybe try and identify the managers that aren't doing so well and invest the time in what the Board should do about those issues rather than reviewing every manager that's outperforming its benchmark and is stable from the Staff.

Ms. Stukes wanted to know what is going to be considered a reasonable time. Ms. McNavish said any manager that had negative net of fee performance over a trailing three year period was automatically on Watch - 1. Probation was more on a qualitative basis. Ms. Stukes asked what is the length of time they are going to be in that step. Ms. McNavish said we haven't gotten to that. Ms. Stukes stated it use to be defined by whatever Staff determined a quarter is.

Mr. Walthour stated the goal is to move away from these specific triggers and focus more on an overall comprehensive assessment of the manager because it's not always performance related why someone goes on the Watch List, it could be Staff turnover, and it could be that they've been bought by a larger firm.

Ms. Pankey asked Mr. Handa, other than Lee Munder Capital Group, is there other mangers that we have terminated that are still holding our money? Mr. Handa said no. Ms. Pankey asked Mr. Handa, does he have a list of contracts pending and are there any contracts that we're trying to finalize that we made commitments with and have not gone into place? Ms. McNavish said Fisher Investments is still pending, Northern Trust is pending, and Rhumblin is amended. Ms. Pankey asked Mr. Handa for a monthly report on the status of contracts along with the dollar amount. Mr. Handa said absolutely.

Agenda Item #6 – Flash Report for the Opportunity Fund Managers for the Period Ended September 2012

Ms. Cherry reported that the performance on the Opportunity Fund was divided. PFM outperformed its target by nineteen basis points, while FIS underperformed.

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The FIS underperformance was primarily driven by the Domestic Equity managers. Herndon underperformed for both PFM and FIS as their process led them to have an underweight to higher beta stocks which were the names that performed well in the index; this was the primary reason for their underperformance. Ms. Cherry indicated there were a few underlying stocks that were down significantly for the month, Western Digital was down 7% and Superior was down 13% for the month.

Edgar Lomax is a manager that Staff has expressed concern about. This FIS manager is down almost 8% over a twelve month period. FIS plans to visit the manager in November and they will report back to Staff on the results of the visit. International manager WCM underperformed for the month; however the manager has a very good longer term track record. Ms. Cherry stated that over the past five years the manager has not had an underperforming calendar year. It has been a difficult environment for this manager on the international side. FIS manager Victoria 1522's performance was up about 5% on an absolute basis. Emerging Markets performed well for the month and the benchmark was a little difficult to beat. Two or three names for Victoria 1522 were the main driver of their relative underperformance. A Brazilian Telecom Company was their largest holding. It didn't perform well during the month.

Ms. Cherry said Mar Vista and Profit remain on PFM's Watch List. PFM is currently seeking a replacement for Mar Vista. Profit's performance had been turning around; however they underperformed slightly during the month of September.

Agenda Item #7 – Chief Investment Officer's Report

Mr. Handa reported at the end of September we made more money with J.P. Morgan's Securities Lending Program than we made last year in aggregate with State Street. The Securities Lending Program is doing well; we are doing much better than last year. State Street's Quality D collateral pool valuation improvements are a result of the low interest rate environment.

Mr. Handa said he is going to put out monthly notes on what the Independence Fund is doing. He said the Board can make their own determinations on whether or not the Independence Fund's monthly performance is meeting the plan's objectives or the Board's desires, if not, please inform him.

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Mr. Dubow asked Mr. Handa if there was overarching theme to the Independence Fund investment strategy and he also inquired about the fund's risk mitigation. Mr. Handa said the objective of the Independence Fund, and what the guidelines say specifically, is it's suppose to be tactical, not use leverage and mitigate risk for the Plan. He stated they can view the flash reports versus the HFRX Event Driven Index. It's not an aggressive strategy, it's a low volatility strategy, and there is not a lot of trading going on and no conflict of interest. He stated he is able to do his job which is to be the Chief Investment Officer of the Plan and also manage the Independence Fund. Mr. Walthour added you can't predict until December but the fund is behaving according to how it was described. Ms. Stukes said she would like to feel more comfortable about the strategies employed and would prefer to have a report from Cliffwater on the Independence Fund. Mr. Walthour stated they have a monthly call with Summit to talk about the portfolio positions. He said we have all the information.

Mr. Handa reported Staff always meets with managers, not just new managers, but also our existing partners, it is important to keep abreast of what we own in the portfolio. Ms. McNavish and Mr. Falkowski had recently met with existing manager Barings.

Mr. Handa stated that the Fund invested in Hedge Fund manager Regiment Capital years ago and then increased the position. In September 2009, the Fund took an initial position, and then increased the position last year. When Staff met with Regiment Capital in August 2011 they were positioned approximately 40% in cash. By January of 2012, they were down to about 38% in cash. When Staff questioned this high cash position in August of 2012, Regiment Capital indicated they were keeping high cash positions due to worries about the Fiscal Cliff. Mr. Handa stated that the Fund pays managers for their judgment and returning 2 ½% over a year, which is equivalent to about what treasuries are doing, is completely unacceptable. He said we need all our mangers to perform and he doesn't believe Regiment doing that and this is why Staff is recommending downgrading them.

Mr. Dubow asked Mr. Handa if we put Regiment Capital on Watch what are the results going to be, where does he think we'll see improvement? Mr. Stagliano said you can put the money in credit and get the same return and wouldn't have to pay the fees associated with a Hedge Fund manager.

Mr. Leonard asked Mr. Handa if this is a vehicle similar to the Private Equity Vehicle they had a few months ago on a committee where they can get the limited partners together and resolve. Mr. Handa said no. He stated we can exit in April of 2013 for \$10 million dollars and we'll

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receive the balance the following June of 2014. Mr. Handa said if you put in for redemption today you won't get half your money back until June of 2014. He said he thinks Staff is deeply worried that performance is going to continue like this.

Mr. Bielli said if we have until April 2013, and we don't see improvement and Staff is unhappy with performance, then the Board would consider redemption because you can always pull that back. Mr. Handa said correct.

Mr. Handa said the decision can be made in March; it does not have to be made today. Ms. Pankey asked Mr. Handa in order to redeem, what is the notification time frame? Mr. Handa said April 30, 2013. Ms. Pankey said we have to notify them by April 30, 2013. Mr. Handa said correct. Ms. Weiss asked Mr. Handa if he was saying we can't put in the request to redeem until April. Mr. Handa said you have until April 30, 2013 and you'll receive the money by June 2013. Ms. Weiss said you won't get the money back. Mr. Handa said you would get the first \$10 million by June 30, 2013. Mr. Dubow stated you can start the planning process now. Mr. Handa said the point is you have time. Mr. Dubow said there is no reason to put in redemption now and that we should be ready to do that and think of alternate investment options. Mr. Handa said correct.

Ms. Pankey made a motion that Regiment Capital be placed on Probation with the intent to redeem and revisit. Mr. Stagliano seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

Ms. Stukes asked Mr. Handa if Regiment Capital would get paid whether we redeem or not. Mr. Handa said yes.

Mr. Handa said he thinks Michael Karsch is a brilliant investor and excellent stock picker. One problem is that the returns have not materialized. The second problem is he's had several people leave his organization. Ms. McNavish went in to visit them earlier in September. He's up 5.9% at the end of September which is an acceptable return for a Hedge Fund Vehicle, however during this year period, it's up less than 2% and there has been turnover. Staff recommends that Karsch Capital be placed on Watch. Ms. Weiss asked Mr. Handa when do we revisit. Mr. Handa said in January.

Mr. Albert made a motion to place Karsh Capital on Watch. Ms. O'Leary seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

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Ms. Weiss asked Mr. Handa if in January, we see that they're not operating up to a standard that's acceptable, what's the redemption time frame for Karsch. Mr. Handa said it's forty-five day notice. Ms. Pankey asked Mr. Handa if it was a full redemption in forty-five days. Mr. Handa said yes.

Mr. Leonard asked Mr. Handa if he mentioned during the asset allocation conversation about having leverage to get distributions quarterly or periodically because of the difficult return and fund raising climate. He asked if there are opportunities in terms of the Regiment problem. Mr. Handa said you can get around it by getting rid of the lockup. Mr. Leonard asked Mr. Handa is there an environment where we actually have leverage to get those types of terms?

Mr. Handa said Staff has been getting a lot of these types of terms in this environment. He said we have already started that process with all of our managers. There have been a lot of things that are going on and we haven't brought it to the Board's attention because we're waiting for the approval of the asset allocation. Along with legal and Staff, we've already negotiated with several of our managers to get rid of this lockup issue.

Mr. Walthour made a point that two years ago you would have had to allocate two hundred million dollars to all these managers to get that customized fee structure in terms of a vehicle for them. Today it's \$50 million. The gating issue of size has gone away.

Ms. Pankey asked Mr. Handa in reference to Regiment Capital if we chose to redeem would we receive the first \$10 million in June 2013 and when would we receive the balance. Mr. Handa said June 2014. Ms. Pankey asked if we would have to give Karsch a forty-five days notice, and would we receive the money in June 2013. Mr. Handa said correct.

Ms. Pankey said to Mr. Handa and Mr. Walthour we now have an asset allocation that we're considering and you will be going to your managers discussing who we're going to keep, who we're not going to keep. These managers that we are now putting on Probation I'm assuming they're going to be part of the conversation of potential terminations. Mr. Handa said correct. Mr. Walthour said yes.

Ms. Weiss – Any other new business

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Ms. Stukes said she was asked to be a coach at the Institutional Investment Roundtable Conference in San Francisco in December. Mr. Disfusco introduced Ms. Ellen Burkovitz. She is the new attorney who has joined Staff. October 1, 2012 was her official date.

Ms. Weiss thanked Mr. Reilly and wished him well. Mr. Reilly announced the Pension Seminar which took place on October 16, 2012. He said they had many people in attendance and it was good outcome. Mr. Reilly said the Executive Director and City Personnel were finally able to get to the fire headquarters and he thanked them. He advised everyone to get their paperwork in by April 15, 2013.

At 11:53 p.m., the Board of Pensions and Retirement had a discussion on some “Old Business” and “New Business”.

At 11:58 p.m., Ms. Weiss requested a motion to adjourn the Investment Committee Meeting. Mr. Albert made the motion. Ms. Pankey seconded it. There was no discussion. All were in favor. There were no oppositions or abstentions. The motion passed.

At 11:59 p.m., Ms. Weiss convened the Board of Pensions and Retirement Meeting to affirm the actions taken at the Deferred Compensation Committee Meeting and the Investment Committee Meeting. Mr. Harvey made the motion. Mr. Albert seconded it. There was no discussion. All were in favor. There were no oppositions or abstentions. The motion passed.

At 12:00 p.m., Ms. Weiss requested a motion to adjourn the Board of Pensions and Retirement Meeting. Mr. Albert made the motion. Ms. Pankey seconded it. There was no discussion. All were in favor. There were no oppositions or abstentions. The motion passed.

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

Paula Weiss, Esquire
Alternate Board Chair