THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
JUNE 27, 2013

MEETING MINUTES

There being a quorum, Rob Dubow, Board Chair, called the Investment Committee Meeting to order at 9:56 a.m., in the Board Conference Room, 2 Penn Center Plaza, 16th Floor.

Present:

Rob Dubow, Finance Director
Paula Weiss, Esquire, Alternate, Deputy Director of Finance
Harvey Rice, Esquire, Alternate, First Deputy City Controller
James Leonard, Esquire, Alternate, Chief Deputy City Solicitor
Brian Albert, Alternate, Deputy Human Resources Director
Celia O'Leary, Alternate, Deputy Director of Human Resources
Carol G. Stukes-Baylor, Employee Trustee
Ronald Stagliano, Employee Trustee
Andrew P. Thomas, Employee Trustee
Folasade Olanipekun-Lewis, City Council Designee

Francis X. Bielli, Esquire, Executive Director
Mark J. Murphy, Deputy Executive Director
Sumit Handa, Esquire, Chief Investment Officer
Brad Woolworth, Deputy Chief Investment Officer
Christopher DiFusco, Esquire, Director of Investment
John Foulkes, Esquire, Investment Officer
Dominique A. Cherry, Investment Officer
Daniel Falkowski, Investment Officer

Also Attending:

Katherine Mastrobuoni, Esquire, Assistant City Solicitor
Ellen Berkowitz, Esquire, Deputy City Solicitor
Daina Stanford, Administrative Assistant
Carmen Heyward, Clerk Stenographer II
Donna Darby, Clerk Stenographer II
Jacob Walthour, Cliffwater
Robert O'Donnell, Esquire, O'Donnell Associates
Will Green, Loop Capital
Charles Jones, Executive Director, Sinking Fund Commission
Michael Banks, Greentree Brokerage
Kung Kun Chen, Intern, Greentree Brokerage
Robert Valleio, Intern, Greentree Brokerage

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Agenda Item #1 – Approval of Minutes of February 28, 2013 and May 22, 2013

Mr. Dubow called to order the Investment Committee Meeting for June 27, 2013.

Mr. Dubow requested a motion to approve the Minutes of February 28, 2013. Mr. Stagliano made the motion and Mr. Albert seconded it. There was no discussion. All were in favor. There were no oppositions or abstentions. The motion passed.

Mr. Dubow requested a motion to approve the Minutes of May 22, 2013. Mr. Albert made the motion and Ms. O'Leary seconded it. All were in favor with the exception of one abstention by Mr. Stagliano. There were no oppositions. The motion passed.

Agenda Item #2 – Additional Capital Recommendation – Mason Capital Management

Mr. Handa stated that Staff and Cliffwater are recommending additional allocation to Mason Capital, to bring the total allocation up to $50,000,000. Mr. Handa said they believe it is between $26,000,000 and $27,000,000 million will be added but are not sure and that is why the recommendation is up to $50,000,000. They have invested with Mason Capital almost four years and the returns over that period of time have been very good. The performance from 2013 has been extraordinary. The hedge fund has made money on both sides, long and short. At the end of May they were up 13%. In 2012 they were down when the market went up.

Mr. Dubow asked Mr. Handa how they were doing this month.

Mr. Handa said he spoke with Michael Martino on Tuesday. Mr. Martino said they were doing fine and would not give specific numbers. Over a four year period they've done very well for us. Over the last six plus months the results have been fairly consistent.

Mr. Dubow asked Mr. Handa how does this fit in our asset allocation.

Mr. Handa said at of the end of May the Fund had 7.6% in hedge funds. This will increase it by $26,000,000 or $27,000,000 or so. We're still underallocated.

Mr. Dubow wanted to know where the funding would come from.

Mr. Handa said the funding would come from domestic equity, where we are currently over allocated at 28%. Mr. Handa said it would come from the S & P 500. We have approximately a little fewer than 6.9% of our portfolio in the S & P 500. One of the reasons why the plan has done well is because of our over allocation to domestic equity.

Mr. Albert made a motion to allocate up to $50 million to Mason Capital. Mr.Stagliano seconded it. There was no discussion. All were in favor. There were no oppositions or abstentions. The motion passed.

Agenda Item #3 - Oaktree Capital Management Update

Mr. Handa informed everyone that agenda item #3 is an information item. There was a request by the Board to find out about the Koch brothers relationship with Oaktree Capital Management and the potential sale of the Los Angeles Times.

Ms. Stukes-Baylor said she doesn't think they are being 100% truthful with us. Ms. Stukes-Baylor said in May she saw an article from the brothers stating they were in the process of taking over the Tribune Co. [owner of the Los Angeles Times].

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

Mr. Handa stated the markets have been very choppy over the last six weeks or so. Interest rates have been the primary cause for it. We have no Treasury exposure in this portfolio. We sold our Core Real Estate in December; therefore, we don't have that exposure. Mr. Handa said they knew this was going to happen but did not know when. They made investments with KKR-PBPR Capital Partners and Apollo Strategic Investment Fund with expectations that this would happen at some point. They made allocations to LEM which is a real estate fund that provides floating rate debt with the potential to capture preferred equity, not just fixed income.

Ms. Olanipekun-Lewis asked Mr. Handa if he expected the type of volatility that resulted.

Mr. Handa said yes. The Federal Reserve has dampened volatility, but volatility has been seen in the VIX Index, which is an indicator of when volatility dropped or increased. Mr. Handa said volatility dropped to 1.11 percentage points, and increased to almost 17 points. Mr. Handa stated volatility has increased and he expects volatility to continue increasing and those good investment managers in this type of environment will do well.

Ms. Olanipekun-Lewis wanted to know how long the markets were going to be choppy.

Mr. Handa said he believes investments and our thought process have to be adjusted. The majority of our managers for June are down. Mr. Handa stated the S& P 500 is up today and we had a significant rally this week.

Mr. Dubow wanted to know if they are down against their benchmarks or are both down.

Mr. Handa responded both.

Mr. Dubow said being down against your benchmark is more trouble.

Mr. Handa replied it's more trouble. The markets rally. It's also our largest exposure as the U.S. Domestic Equity Market. Our fixed income was hit hard in May and will continue to get hurt.

Mr. Walthour reported fixed income is supposed to be the safest part of your portfolio. When you think about how much artificial demand the Fed has created in your fixed income securities by buying eighty-five billion dollars worth of securities each and every month, when that stops there's nothing to fill that gap. You may see an unprecedented sell off and rapid rise in rates if they taper prematurely. Rates have been at all time lows.

Ms. Olanipekun-Lewis asked Mr. Walthour what's going on within the market.

Mr. Walthour said it has a lot to do with the markets hitting all time highs. People are quickly taking profits off the table and we've had a rally in the last couple of days. The companies are not doing as well as many people expect. You'll have the earnings numbers and you'll have the revenues numbers. In the last earnings cycle very few people were able to beat expectations on both. Most of them saw as revenue declined they were able to make the earnings because they were cutting expenses. It's going to be hard to keep that up for an extended period of time. You should start to see a little more volatility in the equity markets.

In the month of May we beat the overall benchmark. The portfolio overall is in a healthy position. There's a lot more positive going on in the portfolio than negative.

During the month of June, equity markets traded off and were positive with the exception of Asia and the emerging markets. MSCI Asia is the worst performing market presently because the Japan trade was being unwound. There is some fear about the real state of economic growth from China. Japan is having a negative impact on the rest of the region. There is a perception that emerging markets are riskier than developed markets. When developed markets trade off, emerging markets usually trade off more.

Fixed Income markets were the worst of the performance coming into the emerging markets bond area but the fund doesn't have a tremendous amount of exposure, behind that Treasuries and Mortgage-Backed Securities. The reason why Mortgage-Backed Securities are trading off is that's the principal area where the Fed has been doing its bond buying.

Alternatives: Hedge funds have been generating 50 basis points to a 100 basis points a month consistently. They've had one of the longest winning streaks that we've seen in a very long time which has been led by long/short equity managers, event driven managers and distress managers. The macro managers that are suppose to make those macro calls have been struggling in the U.S. and abroad. MLPs, commodities and REITs are trading off because they've done well. You are seeing some profit taking in those areas with the exception of gold which is not going well and continues to do worse as an overall area within the commodity sector.

As to the portfolio's performance during the month, the fund was up 34 basis points relative to its index, 54 basis points on a 3-month basis, up 20 basis points for the fiscal year, year to date and up about 9 basis points for the calendar year to date.

There's significant contribution from the U.S. equity portfolio and that portfolio did well in terms of its performance, it was up 2.33% in May. But also you had an 8 point overweight to U.S. equities. That exaggerated the positive contribution to the overall portfolio.

You were up because of the underweight to the non U.S. markets and emerging markets where the managers outperformed but you had negative performance from those specific portfolios.

Investment grade fixed income was the worst performing asset class, down 2 ½ points for May. And there were strong gains, about 3 points each from private real estate and private equity as that performance was reported on a lag basis. And a positive performance from the hedge fund portfolio.

There were managers who made large contributions, managers who made significant contributions and managers who had not done well for the month of May.

In terms of year to date, the MLP trade, probably the best trade of the year. Those managers are still up, into the twenties.

During the month, from an asset standpoint, the underweight to real assets was a positive, the underweight to non U.S. equities was followed by a double positive. There was a negative performance in the overweight to fixed income. Contributions to the overall performance, an overweight to U.S. equities was a positive.

The flash report had positive contributions from five out of the nine categories with the most costly being opportunistic and investment grade fixed income. The portfolio has thirty active managers, sixteen in the long only space, ten in the hedge fund space and four in real assets space. Twenty-one out of the thirty outperformed their benchmark which was good. The performance of the individual managers is good.

The underperformance was 2 basis points for May for the U.S. equity area.

Both of the opportunity fund managers had positive contributions. During the month PFM had 69 basis points and FIS had 42 basis points of outperformance.

Within the Non U.S. Equity Developed the MSCI EAFE index was down 2.41%. Your managers were down 91 basis points; their excess return was 151 basis points for the month.

Within the Emerging Markets there was a negative month but a positive contribution relative to the index.

Within Investment Grade Fixed Income although the markets were down 1.78%, the managers were down 2.49%. When we reviewed one of the managers a couple of months ago there was some discussion about possibly ending additional contributions and we felt it wasn't the right time. When the underlined portfolio was observed, there were things they were doing in the portfolio, in the investment grade category; some of those positions may have gotten hurt. Mr. Walthour stated he did not think it's anything to be concerned about overall.

Opportunistic Fixed Income portfolio is down 149 basis points and the negative return relative to the index was about 130 basis points.

Absolute Return had 56 basis points positive contribution for May above the benchmark after contributing about 91 basis points return for the month.

Seven out of ten hedge fund managers beat their overall benchmark.

Within the Real Assets category, four out of four managers beat their benchmark, a contribution of 1.12% for the MLP managers, but the overall contribution of the Real Assets portfolio is negative as its benchmark is CPI + 5 points.

Public real estate managers, for May, there is a 3.3 point positive contribution relative to the index. On the private side, both equity and debt, these numbers are lagged, you won't be seeing an index return relative to the May benchmark, but very strong contributions from both of 3 percentage points.

Overall, it was a very good month. The active managers did their job. The asset allocation did its job that resulted in a net positive contribution relative to the benchmark.

Mr. Bielli asked Mr. Walthour if he had detailed information of how Axonic Credit Opportunities Overseas Fund exceeded the index.

Mr. Handa explained the U.S. focus on RMBS and CMBS markets. The RMBS markets are about nine hundred billion dollars. It's amortizing about one hundred fifty billion dollars a year. The Federal Reserve is also purchasing 40 billion dollars in Mortgage-Backed securities. You have a floor on the market. There is going to be some tapering probably starting in September, but when you have the floor, the amortizing in effect and bonds from 2003 to 2006. Those are the vintage years that are the primary focus of Axonic.

There's been a recovery in the housing market. They're benefitting from this. When we break out the RMBS market, all day there's junior debt taper. They are able to trade in and out. They are hedge funds; they're also short as well. These are the reasons on the RMBS and CMSB side, commercial generally lags residential by about eighteen months. The residential market started picking up approximately a year and a half ago. You're starting to see the benefits of the commercial side as well, the CMBS side. They are able to purchase securities between 50 cents and 60 cents and also offer coupons around 67 cents. You also receive about 10% yield plus appreciation potential.

Mr. Bielli asked Mr. Walthour if the European banks have to continue to unload that debt to get to the percentages the law requires. Mr. Belli said they can't lend until they get to the percentage, they have to keep a certain amount of capital.

Mr. Walthour said yes. Mr. Walthour said their reserves have to get to a certain level before they feel comfortable lending again.

Ms. Stukes-Baylor inquired about the termination of a manager.

Mr. Handa said they are going to be scrapping the watch system. There's a watch system in the flash report that will be scrapped. We're going to have subcommittee meetings to discuss it in the next couple of months or so, going forward you don't have to see the sheet at all.

Agenda Item #5 – Flash Reports for the Opportunity Fund Managers for the Period Ending May 2013

Ms. Cherry reported both Opportunity Fund managers for the month of May outperformed their benchmarks. The submanagers that underperformed for the month were both of the Herndon Capital Management portfolios, and Victoria 1522 Investments for FIS. One name affected the performance of Herndon Capital Large Cap Value . American Capital Core was down 23%. Boart Longyear was down 35% for the International portfolio. Herndon exited that position. This manager has been dragging the portfolio down for a few months. Herndon was a little late getting out of that position and it affected their performance.

Mr. Dubow asked Ms. Cherry if there was a reason for concern.

Mr. Cherry responded yes. She stated both FIS and PFM were concerned that they were a little late getting those stocks out of the portfolio. They're a deep value manager. They look at some managers and believe there may be value in some of the companies In this case, they held on too long. There was discussion from both managers about Herndon Capital. They expressed concern, and we also expressed concern to PFM and FIS. They are not as concerned about the Large Cap space, American Capital Core. There is not much concern about Victoria 1522 Investments, for the most part, in the longer term; they've had a pretty decent performance. There were a few sectors that were big detractors for the month, energy, financials and materials in general. There were a few names, but they were a single name detractor that was not as relevant as the old sector bets which affected their performance.

The international space hurt both Herndon Capital and Cheswold Lane. For Cheswold Lane it was their sector allocations, consumer discretionary hurt their performance. In general, Cheswold Lane is a manager that performs better. PFM is in the process of taking money from Herndon and allocating more to Cheswold Lane. There is no concern.

Agenda Item #6 – Chief Investment Officer's Report

Mr. Handa said securities lending generated about $310,000. Our contract with J.P. Morgan is at the one year mark. In terms of the contract, the split has changed now to 85/15. We generated superior results in securities lending. Quality D is at $600,000.

Mr. Handa stated after the allocation to Mason Capital, we invested approximately $220 million dollars this year of allocated dollars in total. $70,000,000 has gone to minority women and diversity manager funds i.e. 32% of the allocated dollars has been to minority and women this year.

Mr. Dubow asked Mr. Handa to talk about what happened from March to May for African American firms both in terms of dollars and the number of firms going down.

M r. Handa responded Mr. Woolworth would address this.

Mr. Woolworth said FIS had terminated a manager, the Edgar Lomax Company. They had about 9.1 million dollars and that dropped the number of minority owned firms from 12 to 11.

Mr. Dubow asked Mr. Woolworth who they were replaced by and what was the firm ownership.

Mr. Woolworth responded VRC investment and that it is a large cap value.

Mr. Sumit added they are not a minority owned firm.

Mr. Woolworth added you see the 155 to the150, although, the difference was 9.1 million, there has also been asset increase and that's where you get the difference.

Ms. Stukes-Baylor inquired about Rhumbline.

Mr. Woolworth stated Rhumbline was removed from this list as of 12/31.

Mr. Handa stated the next Board meeting will be July 25, 2013. The August Board Meeting was moved to Wednesday, August 21, 2013.

Mr. Dubow asked if there was any other new business or old business. Nothing was stated.

At 10:38 a.m., Mr. Dubow requested a motion to adjourn the Investment Committee Meeting. Mr. Stagliano made the motion. Mr. Albert seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

At 10:39 a.m., Mr. Dubow convened 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. Mr. Albert seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

At 10:40 a.m., Mr. Dubow requested a motion to adjourn the Board of Pensions and Retirement Meeting. Mr. Stagliano made the motion. Mr. Albert seconded it. All were in favor. There were no oppositions or abstentions. 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