THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
SEPTEMBER 27, 2011

MEETING MINUTES

There being a quorum, Rob Dubow, Finance Director, Board Chairman, opened the Investment Committee Meeting at 10:21 a.m., 16th Floor, Board Conference Room, 2 Penn Center Plaza.

Present:	Rob Dubow, Finance Director Paula Weiss, Esquire (Alternate) Alan Butkovitz, Esquire Brian Albert (Alternate) James Leonard, Esquire (Alternate) Celia O'Leary (Alternate) Ronald Stagliano John A. Reilly Carol G. Stukes Veronica M. Pankey Anne Kelly-King (Non-voting Board Member)
Executive Director:	Francis X. Bielli, Esquire
Deputy Executive Director:	Mark J. Murphy
Chief Investment Officer:	Sumit Handa
Deputy Chief Investment Officer:	Rhonda McNavish
Investment Officer:	Brad Woolworth
Investment Associate:	Dominique Cherry
Investment Associate:	Daniel Falkowski
Also Attending:	Robert O'Donnell – O'Donnell Associates Harvey Rice, Esquire (Alternate) Joshua Stein, Esquire – Law Dept. Benjamin Hinerfeld, Esquire Law Department Tina Byles-Williams – FIS Shalonda Epps – FIS Sara Guice – FIS Arlene Sawyer – Investments Donna Darby – Investments

Carmen Heyward – Investments
Andrew Thomas – Local #22
Firefighter
Kevin Norton – BNY Mellon
Will Greene – Loop Capital Markets
Catherine Lucey – Philadelphia
Daily News
Chester Skaziak – Retiree
Peter Kreher – Visitor
Jose Ortega – JP Morgan
Wayne Pollock

Agenda Item #1 – Approval Of Minutes

Mr. Dubow opened the meeting and requested approval of the Minutes.

Mr. Dubow requested approval of the July 28, 2011 Minutes. Mr. Handa requested that page five, paragraph three, the third line from the bottom, the 6% to be changed to 86%.

Mr. Stagliano made the motion to approve the minutes with the change. Mr. Reilly seconded. The motion passed.

Mr. Dubow requested approval of the August 25th Minutes. **Ms. Pankey made a motion to table the August 25, 2011 Minutes. Mr. Reilly seconded. The motion passed**.

Mr. Dubow requested approval of the August 11th Minutes. **Ms. Pankey made a motion to table the August 11 Minutes. Ms. Stukes seconded. The motion passed.**

Agenda Item #2 - Global Custodial Bank Services Search Subcommittee Recommendation

Mr. Woolworth said that the contract for the Board Custodian, State Street Bank, was expiring, and, as such, Staff initiated a search. Three firms responded to the search, BNY Mellon, J.P. Morgan Chase & Co., and State Street Corporation.

He talked about staff's RFP process and their meetings with the Subcommittee and the managers.

In July, he met with the Subcommittee, and there were questions about getting more transparency. That was followed by a face-to-face with Staff and the three respondents, in August. As part of this meeting, Staff was provided with a detailed fee breakdown and in-depth information on securities lending, cash lending, and capital gains tax issues. All respondents did a good job, and had relatively comparable services. However, one respondent, J.P. Morgan Chase, did stand out on the capital gains tax front by being early in responding to the issue.

Mr. Dubow asked Mr. Woolworth what were the initial proposed fees for the three. He said when they initially responded, BNY Mellon had a flat fee of $290,000, J.P. Morgan had a flat fee of $597,000 and State Street had a flat fee of $500,000. These fees subsequently declined as Staff continued to ask for additional transparency and follow-up meetings.

The finalist meeting with the Subcommittee was held September 14, 2011. Looking at all three proposals, Staff provided a breakdown for gross securities lending income, and then provided a detailed fee waterfall of what the Board would receive in net fee income, standardized to see which respondent provided the best economics Mr. Woolworth said that he made the recommendation to go to J.P. Morgan Chase based on superior economics and the firm's overall response.

Mr. Dubow asked Mr. Woolworth to detail the fees and income for the Board to help the members get a sense of the differences between each respondent. He said, using a standard amount, if he ran gross securities lending income through the BNY Mellon fee waterfall, the net fee to the City would be, approximately, $1.2 million, if he ran it through the same fee waterfall for J.P. Morgan, it would be, approximately, $1.6 million, and, if he ran it through State Street, it would be, approximately, $1.2 million.

Mr. Stagliano asked Mr. Woolworth to go over the capital gains tax issue with the income on the international side. Mr. Woolworth stated that the fund was tax exempt, domestically and the capital gains tax issue was only related to the Fund's international investments. The capital gains tax issue was in relation to other sovereign governments, for example, Taiwan, if the Board invested there, they would pay a tax on any investment gain if the Fund wanted to redeem capital. As such, Taiwan requires that investors have a legal tax office in the country to compute taxes for the City, and it was a problem for pension plans; because, they had to get someone there to do the tax calculation. Staff looked for someone to solve the issue on their behalf. All three looked into it, and J.P. Morgan was ahead of the curve and had done a lot of work on it. In a couple of markets, they had solved the problem. The others were nipping at their heels and close to working out the issue some of the markets.

Mr. Dubow asked for a motion of approval. Ms. Stukes made the motion to accept J.P. Morgan as the Board's new custodial bank. Mr. Albert seconded. The motion passed.

<u>Agenda Item #3 – Manager Performance Review – Trilogy</u>

Ms. Epps recalled that Trilogy was downgraded to Watch-1 at the last meeting. FIS' summary provided an update on what was going on with the manager and the reason for the underperformance for the period.

Ms. Epps said that Trilogy was hired for the fund in December 2008 and did a great job, They outperformed their index in 2009 by 149 basis points, gross of fees, and significantly less on the net of fee basis. In 2010, they outperformed gross of fees, but lost money on a net of fees basis. They struggled as well in the first two quarters of 2011. In 2011, the market changed drastically on Trilogy's program, with the interest rate hikes in 2011 in the Emerging Market space.

Ms. Epps said that Trilogy was hired with Eaton Vance, who was hired as a value manager, giving downside protection for the year-to-date period, and Trilogy, a more growth-oriented manager, giving upside capture. Trilogy stumbled significantly during the 2011 calendar-year-period, because of their total weighting to economically sensitive sectors.

Ms. Epps said that (page 2) both managers were placed into the portfolio as a compliment to the other, which they had done, thus far. On a whole, emerging managers added about, 115 basis points since inception, on a gross-of-fees basis, and outperformed, about, three basis points, net of fees. The coupling of the two worked for the portfolio. The trouble was if there was a manager who could give both upside and downside participation. FIS will be flushing that out with Staff within the next few months.

FIS' recommendation was to hold Trilogy in the portfolio, because they gave the upside market appreciation, and should the markets reverse, they would not want to lose that.

Mr. Dubow asked Ms. Epps if their recommendation was to stay the course now, but to look to see if someone might be a better fit. Ms. Epps said, yes.

Ms. Pankey asked Ms. Epps if they had a time frame. Ms. Epps said that FIS would talk with Staff about the time frame, and she knew that they would be visiting Trilogy within the month. So, once they visited with them, FIS would come back to talk, again, and they would have a decision for the Board.

Mr. Handa said that Staff was currently grappling with many issues, as it related to the global economy and continued to struggle with a consensus view that their had been a decoupling of the Asian economies from U.S. and Europe. Staff was challenged by that and by what should be the appropriate level of their exposure and how much it should be expressed within the Fund. It was for that reason that Staff downgraded Trilogy last month, and they concurred with many of the conclusions in the FIS' report. However, again, they would like to do an on-site visit for October 20, 2011. They will meet with the management to review their thoughts and concerns. He asked that the Board wait until that time, until they met with them to formulate a conclusion.

Mr. Dubow asked Mr. Handa if, before the meeting, they would be looking into other options. He said, right, and staff was grappling with what was going on in the world, and the best way to express it in the portfolio, so that they could participate, as well as protect themselves.

Mr. Dubow asked the Board members if anyone had concern about that approach. No one expressed concern. He said that the Board would not need to vote on that.

Agenda Item #4 – Flash Report for the Period Ended August 31, 2011

Ms. Epps distributed a revised Flash Report to reflect the Strategic Fund as being included in the total fund market value for the period. There was a change to the total fund performance. Before, it was –3.59. FIS reconciled with the custodian bank, and it was changed to -3.43, the impact on adding the Strategic Fund Market update in affecting total return.

Ms. Epps provided a brief market commentary, saying that the market was the same since last August and looking up. The least bad asset class was Large Cap Equity. Year-to-date, the Russell 1000 index led over Mid Cap and Small Cap companies. In the Non-U.S Equity space, Emerging Markets slightly outperformed Developed Markets, but underperformed Developed Markets, year-to-date. Treasuries were the best performers with the 10 Year Treasury Index up 566 basis points for the month and leading year-to-date over all asset classes. High Yield was the worst performing index for the month, down 4%. Safe haven currencies, commodities and gold were the place to be for the month. The strongest currencies in August were the Japanese Yen and the Euro.

Ms. Epps (page 2) updated for Domestic Equity, that Mid Cap manager Geneva Capital would be funded in September, and Ceredex Value Advisors was still pending contract completion. In the Core Bond space Merganser Capital Management was scheduled for funding in October. For the new accounts, the $43.0 million Strategic Fund was funded.

Mr. Dubow asked Ms. Epps if FIS' report could give a description of the account with the numbers going forward.

Ms. Byles-Williams (page 3) reported that the US Equity allocation was consistent with the 2010 target allocation. The fund bond allocation was close to the target allocation that was approved in 2010. Both the target US Equity and bond allocations had been reduced substantially. Fixed Income was still above target and was being used to start to fund the Real Assets portfolio. Forty million of the real assets portfolio was funded during August.

Mr. Dubow (page 4) noted that the report was showing value subtracted related to Domestic Equity and Fixed Income. He asked if it would look different at longer periods, and if it would be helpful for the report to show year-to-date or longer than one month. She said that was why she went to page five, because five did show the longer periods.

Mr. Dubow asked Ms. Byles-Williams if it got to the value-added by class. She said that the value-added calculation was a blend of the excess return, times the weighting of the class in the portfolio. He requested that it show the value weighted over class for the longer-term. She continued in saying, for value-added (page 5) over the last month, the fund was ahead of the Policy index by 83 basis points gross and an estimated 80 basis points net of fees.

Mr. Dubow confirmed with Ms. Byles-Williams that, except for the inception, they were ahead of the index for every period.

Board discussion focused on the Fund's management fee expenses. Ms. Byles-Williams acknowledged the heartburn about the efficacy of the fund's management program, noting from 2009 and 2010, with the heightened correlations, the active managers did awfully, for the three-year-period. So, while there was positive value added, it was the lowest period. So, something systemic hurt most of the fund managers. She recalled from prior discussions, where systemic, heightened correlations stopped or abated at the end of 2010, showing a marked improvement in value-added in subsequent periods. She noted that it was a cycle and not a fundamental change. Looking at the seven-year period, the management program added, net of fees, 60 basis points.

Ms. Weiss said that the information Ms. Byles-Williams presented did not take into account the management fee expenses related to the consultants. Ms. Byles-Williams talked about using the Passive or the Active Strategy style management, with the fees, saying that a policy decision needed to be made before the fees were subtracted.

<u>Agenda Item #5 – Flash Report for Opportunity Fund Managers for the Period ended August 31, 2011</u>

Ms. Cherry reported split performance between the two Opportunity Fund portfolios, where FIS slightly outperformed by 38 basis points and PFM underperformed, by, about, 49 basis points.

She noted a correction on the FIS flash; the since inception total for InView Investment Management should be -1.39. Ms. Cherry reported that Moody Aldrich Partners, who was on Probation, and Strategic Investment Partners, who underperformed in September, would be reviewed at the end of the Quarter.

Ms. Cherry said that staff had expressed concern about Moody Aldrich's performance to FIS, and that FIS responded that they would look at both managers at the quarter end to assess whether there are any significant concerns and make potential recommendations at that time..

Mr. Dubow asked Mrs. Williams how their five-year number did. She said through June 2011, they were up by 790 basis points from 1977. From December 31, 1997, through June 30, 2001, their annualized performance was 800 basis points above the benchmark.

Mr. Butkovitz asked Mrs. Williams what about their strategy made it a long view? She said that the portfolio manager had a concentrated portfolio with high conviction and was a talented stock picker, but focused on economic cyclical sectors, like materials and energy, things that would not do well when the economy was not growing.

Mr. Butkovitz asked Mrs. Williams how far back did they have to reach to show positive results with the manager? She said that their troubles began mid-March of 2011. Prior to that, they were substantially above the benchmark.

Mr. Butkovitz asked Mrs. Williams if it was an appropriate benchmark for what they did. She said that it was. Mrs. Williams stated that in her opinion, the issue should be whether or not the manager produced value over a market cycle. She added that FIS has known them for ten years, and that in her opinion, and she feels that many would agree, that the manager will have rough spots, but, over a market cycle, they do produce value.

Agenda Item #6 – Passive Manager Search – Subcommittee Recommendations

Mr. Falkowski said that a search was initiated in May of 2011, because the Fund's two Passive managers, Rhumbline and Northern Trust, had contracts that were expiring.

Staff evaluated five firms for five different mandates. They evaluated Alliance Bernstein, Mellon, Northern Trust, Payden & Rygel and Rhumbline. The Passive Manager Subcommittee Met on September 30, 2011, to go over them.

The Subcommittee decided to recommend rehiring Northern Trust and Rhumbline for their respective mandates.

Mr. Dubow asked Mr. Falkowski what was the rationale? He said that Staff was happy with the relationship with Northern Trust and Rhumbline. They were happy to respond to Staff's requests and went outside of the mandate to respond to additional inquiries. Both were very responsive in giving research and providing information to achieve various goals. Also, both had a low tracking error versus their respective benchmarks, which is the prime objective of a passive manager.

Mr. Dubow asked Mr. Falkowski what was an acceptable range for tracking error? He answered that the RFP was looking for less than .75%.

Mr. Falkowski said another important part of the responsibility of the index manager was to be very responsive to Staff's rebalancing needs that often resulted in several inflows and outflows of money from the passive funds. So, it was important that a passive manager worked well with Staff, the consultants and the transition manager. Staff's experience with Northern Trust and Rhumbline worked well, and they were very responsive, with no issues.

All together, Staff and the Subcommittee felt that it was a wise decision to continue on the current path.

Mr. Dubow asked Mr. Falkowski what were the fees? He answered that Rhumbline and Northern Trusts were the lowest versus the respondents for their respective mandates.

Mr. Dubow requested a motion to approve. Ms. Stukes made a motion to retain Rhumbline and Northern Trust. Ms. Pankey seconded. The motion passed.

<u>Agenda Item #7 – Chief Investment Officer's Report</u>

Mr. Woolworth reported for Securities Lending, that since inception, approximately, $30.0 million in income, or $30.4 million was generated. As requested, he included some of the accounting work in Securities Lending about the current value of the quality of the portfolio.

The AUM report for Diversity managers was not the full report that was done on a Quarterly basis, but gave a sense of what was going on, and that it was in line with the prior AUM, reflecting a little decline in the public markets.

Mr. Handa talked about the challenges of investing in bear and bull cyclical environments, with how the fund managers invested for the fund. He cited the reaction to the market in defaulting to cash. He advised that buying at the bottom or selling at the top was not the objective, but to buy a great company when it was cheap and sell when it was fairly valued. Staff was charged with doing that, investing in managers that they considered as undervalued and selling the managers that they believed were fully valued. It has always been and always will continue to be his intention to provide a road map to the Board to tackle the challenges of underfunding and to meet the fund obligations.

The only object that was derived was the best course of action, and, if that route was not acceptable, he would provide alternatives, as they were suggestions. He said that he would continue to provide all Board members with necessary information, so they could decide on the right course of action. It continued to be his belief that greater transparency would only bolster the fund's performance, and the communication was meant to be a two-way street. If there was dissatisfaction with the way that the message was being relayed, he appreciated being told. He, too, made mistakes and would make an earnest effort to correct those errors in his judgment. He offered to respond to questions.

Mr. Stagliano confirmed with Mr. Dubow that the cash flow for the fund would be the same time next year, with the main payment coming in March. The money from the state would come around in October, to get it done within 30 days. Mr. Reilly asked Mr. Dubow if there would be a bump up from the state. He said that there might be, but he did not know the details on it, and he was trying to figure it out, if it would be a good thing.

Ms. Stukes requested that pending work by the Board be updated at the next meeting to address the questions about the policy, the new Strategic Fund that was not being discussed and where it was. She would like the new CIO to include that in his commentary, too.

She requested an update from Ms. Pankey's request in the Minutes of August 25, 2011, for an outline of staff's duties and responsibilities that was supposed to be presented at the present meeting. She requested an update on the Law Department's, since the Board was talking about fees and the staff, position on the Strategic Fund Policy. She was told that there was a motion made to move the $43.0 million to create the fund. She requested to see the motion, because she did not remember the motion being made, and if it was part of the minutes that were being tabled, she would like for it to be included in the minutes.

Ms. Stukes recalled that the Board fired the Hedge Fund consultant, with further action put on hold, because it was felt that staff could do that responsibility. She asked what was the role of the Board and who would oversee staff when they became managers. All of that was discussed, and she did not receive an update on that.

Ms. Pankey asked when would they have the information, so that they could move on the project that they voted to put in place?

Mr. Dubow said that his understanding was that there were no movements towards investments, and it was waiting for the policies to be done. He deferred to Mr. Handa as to when the guidelines would be done. Mr. Handa said that he spoke to three other pensions plans and shared the information with legal, and they were in the final stages of having guidelines put in place. He added that it took a lot of time, because they wanted to make sure that it was right, before they presented it to the Board for approval.

Ms. Stukes asked if there was another operating account in addition to the cash account that they had at State Street. Mr. Handa said, no, that it was the Operating Account, and underneath the Operating Account was the K-76H Account about which she was talking.

Ms. Stukes said that she had never seen anything created and given a special title, and to her, it was a movement of money without the approval. She said when she questioned him about it, yesterday, Mr. Handa said that there was a motion to create the account. She said that she recalled the motion to create a tactical fund, not to put the money in an account with a title.

Mr. Dubow asked Ms. Stukes if her issue was concern that there were actions being taken that they had not discussed. She said, yes. He expressed his understanding that they all agreed that they were taking the money out of our managers and that the funds would be available for Staff to invest once the guidelines were established and approved. His understanding was that was what was going on, and nothing happened, but they were waiting to establish guidelines. If something happened that was different, someone should tell him.

He said that there was a question as to when the guidelines were supposed to be done.

Mr. Bielli informed that the guidelines were done, and there were multiple drafts.. They were compared to other jurisdictions. He noted that they were more complete than other jurisdictions that did in-house investing. They were waiting for an answer from an outside source on the management piece. The timing was within the control of the Board. They would meet with them within the week. So providing guidelines to the Board was contingent upon the Risk Management portion being addressed, also. The guidelines would be done and presented in October with Risk Management Solutions and everything would be ready to go at that point, in terms of things going forward.

Ms. Pankey asked Mr. Bielli did there require a change to the current investment policy, because there was nothing in there that talked about internal investing. He said, right, that there should be a couple of paragraphs and sentences added to the investment guidelines. She asked if Law was working on that, as well. He said, yes, as well as looking at all of the guidelines, whether it was hedge fund guidelines or general investment policy guidelines.

Ms. Stukes asked Mr. Bielli who would be the Risk Control Manager when staff took on the position of consulting? He said that they hoped to have an independent risk manager and would know more about that within the week. She asked if there was an RFP process. He said, no, that they would not in that case.

At 11:55 a.m., Rob Dubow requested a motion to adjourn the Investment Committee Meeting. Mr. Albert made the motion. Mr. Stagliano seconded. The motion passed.

At 11:55 a.m., Rob Dubow reconvened the Board of Pensions and Retirement Meeting to affirm the actions taken at the Deferred Compensation Plan Committee Meeting and the Investment Committee Meeting. Mr. Albert made the motion. Mr. Stagliano seconded. The motion passed.

At 11:55 a.m., Rob Dubow requested a motion to adjourn the Board of Pensions and Retirement Meeting. Mr. Albert made the motion. Mr. Stagliano seconded. The motion passed.

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

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Robert Dubow, Finance Director
Board Chairman