

**AGENDA ITEM I:  
INVESTMENTS**

**Pension Commission  
City Conference Room  
260 Constitution Plaza  
Friday, February 27, 2009  
8:00 a.m.**

<b>MINUTES</b>
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**INVESTMENT PROGRAM**

**MEMBERS PRESENT:** Peter Stevens, Chairman; Frank Lord, Commissioner; Gene Goldman, Commissioner; Kathleen Palm Devine, Secretary

**MEMBERS EXCUSED:** Walter Remes, Employee Representative

**STAFF PRESENT:** Gary L. Carter, Director of Investments; Gary B. Draghi, Assistant Director of Investments; J. Sean Antoine, Principal Administrative Analyst; Denise Aguilera, the MERF's General Counsel; Donna Parker, Plan Administrator

**OTHERS PRESENT:** Cynthia Steer, Rogerscasey, MERF's General Investment Consultant; Maykala Hariharan, Rogerscasey, MERF General Investment Consultant; Tad Fergusson, Pension Consultant Alliance, Alternative Investment Consultant

Chairman Peter Stevens called the Investment portion of the meeting to order.

**I. Review of Minutes: Regular Meeting of January 23, 2009**

Chairman Stevens introduced the item and asked for questions, comments or corrections. There were none.

**A motion was made, seconded and adopted to accept the minutes as presented.**

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## **II. Status of the MERF Portfolio as of January 31, 2009**

Chairman Stevens introduced the item. Secretary Devine requested that the Investment Unit report. J. Sean Antoine, the MERF's Principal Administrative Analyst, reported that at January 31, 2009, the market value of the MERF's investment portfolio approximated \$836.8 million. He stated that the portfolio generated a negative 4.7% return net of fees for the month, outperforming the MERF policy benchmark return of negative 5.2%.

Mr. Antoine reported that the MERF's domestic equity portfolio reported a negative 6.7% net return for the month, outperforming the Russell 3000® Index return of negative 8.4%. Mr. Antoine then noted that the MERF's international equity portfolio generated a net return of negative 7.6% for the month, outperforming the Russell Global ex-U.S. Equity Index return of negative 8.6%.

Lastly, he reported that the MERF's total fixed income portfolio posted a negative 3.0% net return for the month, lagging the custom fixed income benchmark return of negative 1.9%, and that the Liquidity Fund generated a negative 7.1% net return for the month.

**The Commission accepted the report for advice.**

## **III. Consideration of Recommendation Regarding Liquidity Fund**

Chairman Stevens introduced the item. Secretary Devine began by noting that the Commission had approved a two-tiered approach to the structuring of the MERF's liquidity fund in October 2008. She noted that one tier would provide liquidity while the other would be used to ensure diversification through the use of passive index funds. She noted that since that Pension Commission meeting, she, staff and Rogerscasey, the MERF's investment consultant, had been working diligently to properly structure this two tiered approach. She stated that, as part of this effort, Rogerscasey had presented alternate scenarios for a liquidity fund totaling either \$102 million or \$120 million (one and one half years' estimated cash flow needs) for benefit payments. Secretary Devine stated that she believed the proposed scenarios were overly complicated and would be very difficult to monitor, especially considering the MERF's reduced asset size.

Secretary Devine then recommended that, since the liquidity fund must provide for the cash needs of the MERF in a manner that is separate and distinct from the asset allocation fund, the first tier be established as a separate "Benefits Payment Fund"

### **Consideration of Recommendation Regarding Liquidity Fund (continued)**

sized at approximately \$100 million to \$120 million and invested entirely in cash, certificates of deposit (CDs) of two years' or less duration and short-term U.S. Treasury securities. She noted that this fund could be managed in-house by Treasury personnel to save on management charges and other fees. She then stated that the other tier of what had been the liquidity fund should constitute the MERF's passively managed allocation. She noted that this would be named the "Asset Allocation Fund," sized at 25% of the MERF's overall assets and invested in two or three global index funds.

Using this approach, she said, the MERF's return assumption would undoubtedly decrease to 7.5% from 8%, with a corresponding decrease in risk. Cynthia Steer and the Investment Unit said they concurred with Secretary Devine's recommendations. Ms. Steer emphasized that, during these difficult economic times, preservation of capital was critical. As a further hedge against inflation, she said, gold and other commodities may well be worth considering at some point, as it appeared the global markets were heading into a period in which there might be no reserve currency.

The Commission questioned the concept of managing the Benefits Payment Fund in-house instead of having an external party manage the fund, asking whether the Treasurer's Office had the necessary depth and expertise. Secretary Devine stated that her office manages between \$40 million to \$90 million of short term investments on behalf of the City's General Fund on any given day, with these funds invested in CDs, money market funds and the State Treasury Short Term Investment Fund (STIF). Therefore, she said, she believed that with the proper investment policy and internal controls and procedures, the Benefits Payments Fund could indeed be internally managed. Nevertheless, she stated, she would ask staff to engage in discussions with BNY Mellon, the MERF's master custodian, and State Street Global Advisors regarding the merits of using an external advisor. Discussion ensued.

Secretary Devine noted that the establishment of the Benefits Payment Fund would result in an increase in the MERF's cash allocation from 1% to approximately 15%, which was unprecedented, but that the new Benefits Payment Fund was needed as a tactical play for the immediate future to ensure the payment of retirement benefits and provide cash for administrative expenses and the funding of private equity investment commitments.

**A motion was made, seconded, and unanimously adopted to authorize the establishment of a Benefits Payment Fund as proposed by Secretary Devine. A motion was further made, seconded and adopted to authorize the in-house**

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### **Consideration of Recommendation Regarding Liquidity Fund (continued)**

**management of the Benefits Payment Fund pending due diligence on the relative merits of internal versus external management. A motion was further made, seconded and adopted to authorize the establishment of an Asset allocation Fund as proposed by Secretary Devine, to be invested in a global fixed-income index fund and a global equities index fund.**

#### **IV. Consideration of Report from Pension Consulting Alliance Regarding Proposed 2009 Investment Plan for the Alternative Investment Program (with Presentation by Tad Fergusson, Pension Consultant Alliance)**

Chairman Stevens introduced the item. Secretary Devine asked Mr. Tad Fergusson of Pension Consulting Alliance (PCA), the MERF's private equity consultant, to address the Commission. Mr. Fergusson presented the 2009 investment plan for the MERF's Alternative Investment class, noting PCA's observations on the current market environment, recent fund activity and cited perceived opportunities for the calendar year.

Mr. Fergusson stated that, since establishing the program in early 2002, the MERF had committed approximately \$108 million in capital across 14 partnerships. Mr. Fergusson stated that for the 2009 calendar year, PCA recommended \$20 million in commitments in two to five partnerships, with an average commitment size of \$5 million-\$10 million per partnership, within a variety of investment types. Discussion ensued.

Mr. Fergusson stated that the target allocation ranges from 4% to 10% of the MERF's total investment portfolio. He noted that, given the most recent valuation data (as of September 30, 2008), the program is projected to have a year-end market value of approximately \$46 million, representing 5% of the MERF portfolio and within the targeted policy range as of December 31, 2008. Discussion ensued.

Secretary Devine then noted PCA's recommendation that the MERF consider decreasing the alternative investment program's long-term performance objective from a 500 basis point premium over public equity market returns to a 300 basis point premium. She stated that PCA had cited a slight downward trend in long-term private equity returns and the MERF's relatively conservative approach to portfolio construction as reasons for the recommendation. She then asked Mr. Fergusson to comment.

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In general, consultants have decreased their long term return assumptions for private equity markets, Mr. Fergusson said, and hence PCA's recommendation. Secretary Devine stated that she and Mr. Carter believed that the MERF program's focus on the smaller capitalization end of the private equity market and its past performance supported retaining the higher return assumption at this time. Mr. Carter stated that staff is still working with PCA to determine the veracity of PCA's assertion of decreased liquidity premiums. Discussion ensued.

**A motion was made, seconded, and unanimously adopted to accept PCA's report regarding the proposed 2009 investment plan and the recommendations therein for Calendar Year 2009. A motion was futhre made, seconded and adopted to maintain the target private equity return premium at 500 basis points over public equities markets.**

**V. Consideration of Recommendation Regarding Mondrian International Fixed-Income Portfolio**

Chairman Stevens introduced the item. Secretary Devine recommended that the Pension Commission retain Mondrian Investment Partners Limited as the MERF's international fixed income manager, rather than moving the management of the portfolio to Brandywine, as had been previously recommended and approved last year. She noted that the Investment Unit and she believed that this was the correct strategy and that Rogerscasey was in agreement.

Secretary Devine noted that, during the search for a manager to fill the MERF's international fixed income mandate, four excellent firms made presentations. Ultimately, the Commission approved the selection of Brandywine based on presentation materials which seemed to show that Brandywine had achieved the same or better returns as Mondrian with less risk, she said. Upon subsequent review, she said, it was noted that Brandywine and Mondrian had presented against different benchmarks, resulting in a distortion of their respective risk adjusted returns.

Secretary Devine noted that when the Commission authorized the change from Mondrian to Brandywine, it gave the Secretary authority to act on a tactical basis. She and staff had not transferred the mandate to date, she said, due to the onset of

**V. Consideration of Recommendation Regarding Mondrian International Fixed-Income Portfolio**

the credit crisis and related unprecedented market disruption. In the interim, she said, she, the staff and Rogerscasey had continued to monitor both firms.

Secretary Devine stated that over the past year, Brandywine's performance had deteriorated significantly, while Mondrian had performed well. For this reason, Secretary Devine stated she, staff and Rogerscasey saw no justification for moving the funds. She then recommended that the MERF enter into a new contract with Mondrian for this mandate, given the fact that the extant contract was with Delaware Investment Advisors (with Mondrian as a sub-advisor for the international portion of the portfolio), and Delaware no longer played a role in the management of the portfolio. Cynthia Steer stated that Rogerscasey concurred with the Secretary's recommendation.

**A motion was made, seconded, and unanimously adopted that the MERF retain Mondrian Investment Partners and not Brandywine for the MERF's international fixed-income portfolio, pending successful contract negotiations.**

**VI. Report on Annual Performance Review Meeting with State Street Global Advisors**

Chairman Stevens introduced the item. Secretary Devine stated that the report was self explanatory. She asked if there were any questions. There were none.

**The Commission accepted the report for advice.**

**VII. Other Business**

Chairman Stevens introduced the item. Secretary Devine stated that she had provided miscellaneous communications from some of the MERF's vendors for the Commission's information. Discussion ensued.

**There being no further business, Chairman Stevens adjourned the meeting.**

ATTEST: \_\_\_\_\_  
Kathleen Palm Devine, Secretary