VERMONT PENSION INVESTMENT COMMITTEE
February 22, 2011

VPIC Members Present:
STEPHEN RAUH, CHAIR
BETH PEARCE, VICE-CHAIR, Vermont State Treasurer
VAUGHN ALTEMUS, Governor's Delegate, term expiring June 30, 2014
ROBERT HOOPER, VSERS Representative, term expiring June 30, 2012
STEVEN JEFFREY, VMERS Representative, term expiring June 30, 2014
DICK JOHANNESEN, Governor's Delegate, term expiring June 30, 2014
JOSEPH MACKEY, VSTRS Representative, term expiring June 30, 2011

VPIC Member(s) *Absent*:
NONE

VPIC Alternate Members Present:
KEVIN GAFFNEY, VSERS *Alternate*, term expiring June 30, 2012
THOMAS GOLONKA, VMERS *Alternate*, term expiring June 30, 2012
JON HARRIS, VSTRS *Alternate*, term expiring June 30, 2011

VPIC Alternate Member(s) *Absent*:
KAREN PAUL, *Alternate* Governor's Delegate, term expiring June 30, 2012

Also attending:
Steve Wisloski, Deputy State Treasurer
Bill Griffin, Chief Assistant Attorney General
Jaye Pershing Johnson, Assistant Attorney General
Chris Levell, NEPC LLC
Kevin Kondry, NEPC LLC
Linda Deliduka, VRTA Alternate Representative, VSTRS Board of Trustees

CALL TO ORDER:

The Chair, Mr. Rauh, called the Tuesday, February 22, 2011 meeting to order at 8:31 a.m., which was held in the 4th Floor Conference Room, 109 State Street, Montpelier, VT.

ITEM 1: Agenda Approval, Announcements, and Minutes of January 25, 2011 Regular Meeting

Mr. Wisloski announced that he and Mr. Altemus were carpooling to the Wellington Compliance Conference in Boston on March 3 and others were welcome to join. Mr. Wisloski also reminded the Committee about NEPC's annual conference in Boston on May 18-19 and that the Treasurer's Office would coordinate registration and hotel reservations.

The Committee unanimously approved the Agenda and minutes of the January 25, 2011 Regular Meeting by voice vote.

<u>ITEM 2:</u> Discussion of Travel and Education Policy

The Committee discussed VPIC's Travel and Education Policy. Mr. Rauh asked Mr. Wisloski to keep a list of conferences attended, as well as travel and education expenses for each VPIC member. Ms. Pearce stated for the record that she would not support large annual per-member expenses, in the range of $10,000 to $15,000, especially given the State's tight budget. Mr. Jeffrey concurred with Ms. Pearce. Mr. Altemus suggested that van pools to regional conferences and universities could hold down expenses. Mr. Johannesen inquired whether NEPC would make its research available on a client intranet; Mr. Levell indicated he would look into it.

By unanimous voice vote, the Committee pre-authorized travel to the Wellington Compliance Conference for any members planning to attend.

<u>ITEM 3:</u> Review of Contracts

Mr. Wisloski reported that amendments extending PIMCO All-Asset, Mellon Global Asset Allocation, and the State Street Custody contract each for five (5) years through March 31, 2016 were in process. Ms. Pershing Johnson reported that the Morgan Stanley Prime Property Fund would need a new contract. Mr. Kondry reported that neither PIMCO nor Mellon were able to negotiate fees because the funds are commingled and require equal terms to all investors. Ms. Pearce asked if NEPC planned to provide a formal fee analysis for all VPIC's managers; Mr. Levell indicated that they did.

Mr. Gaffney arrived at 9:00 a.m.

<u>ITEM 4:</u> VPIC Standards of Conduct Disclosure

The Committee discussed the form and substance of information required to be provided in the annual "Standards of Conduct Disclosure for VPIC Members." The Committee agreed that personal investment information, such as dollar amounts of specific investments, was not required, nor were investments unrelated to VPIC (for example, checking and savings accounts, CDs and mutual funds).

<u>ITEM 5:</u> Appeals to VPIC for Direct Investments

The Committee discussed several recent inquiries regarding possible direct investment of VPIC funds in Vermont-based initiatives. Mr. Rauh reviewed an outline of talking points with the Committee that enumerated reasons VPIC is unable to make such investments, including that VPIC invests with professional managers versus directly, and VPIC is otherwise unable to perform due diligence, analysis, deal structuring, setting of terms, pricing, and ongoing monitoring of direct investments. Further, pursuit of objectives that are not fully aligned with VPIC's stated investment goals (for example, pursuing economic development despite potential substandard returns or excessive risk) could cause VPIC to breach its fiduciary duty and potentially create personal liability for VPIC members.

ITEM 6: **VPIC Manager Fees**

Mr. Kondry reviewed a table that compared VSTRS weighted average fees to the fees of six other NEPC clients with between $1 billion and $5 billion of assets under management. VSTRS' weighted average fees were 49 basis points (0.49%) of assets per year, compared to a range of 32 to 75 basis points for the other systems surveyed. The average fee for the other systems (not weighted by assets) was 53 basis points.

ITEM 7: **Governance Questionnaire**

The Committee reviewed "Developing a Culture of Good Governance," a survey asking whether members Agree, are Undecided, or Disagree on 50 questions organized into five (5) categories of Mission Awareness, Governance Structure, Decision-Making Process, Attitudes and Biases, and Controls.

Mr. Harris arrived at 10:00 a.m.

The Committee generally thought VPIC was very cognizant of its mission, had made substantial improvements in governance by virtue of a smaller Committee, had open and honest discussions regarding decisions, and was generally well-informed. The primary area identified for improvement was in controls, and the Committee asked Mr. Wisloski to collect the risk management and disaster recovery plans for all of VPIC's managers.

ITEM 8: **NEPC Q4 Portfolio Review**

NEPC reviewed fourth quarter performance results, focusing on individual managers' performance. Strong positive contributions by active managers have given VPIC excellent results in the past 12-month and 24-month periods, however Q4 performance lagged due to the sharp run-up in equity prices and relative underweight of VPIC's portfolio to that asset class. Detailed results by manager are reported quarterly by NEPC. Performance for the individual plans was as follows:

VSTRS:
The fourth quarter 2010 performance reported a market value fund balance of approximately **$1.477 billion** and a gross quarterly return of 4.6%, performing well below the total public funds median ranking in the 89th percentile. The one-year return was reported at 14.7% ranking in the 21st percentile, three-year return of 0.5% ranked in the 58th percentile, and a five-year return of 4.5% reported in the 53rd percentile of the median public fund universe.

VSERS:
The fourth quarter 2010 performance reported a market value fund balance of approximately **$1.321 billion** and a gross quarterly return of 4.8%, performing well below the total public funds median ranking in the 81st percentile. The one-year return was reported at 15.1% ranking in the 9th percentile, three-year return of 1.1% ranked in the 44th percentile, and a five-year return of 4.8% reported in the 40th percentile of the median public fund universe.

VMERS:
The fourth quarter 2010 performance reported a market value fund balance of approximately **$373 million** and a gross quarterly return of 4.8%, performing well below the total public funds median ranking in the 84th percentile. The one-year return was reported at 15.0% ranking in the 15th percentile, three-year return of 1.4% ranked in the 38th percentile, and a five-year return of 4.9% reported in the 35th percentile of the median public fund universe.

BURLINGTON:
The fourth quarter 2010 performance reported a market value fund balance of approximately **$114 million** and a gross quarterly return of 4.7%, performing well below the total public funds median ranking in the 85th percentile. The one-year return was reported at 15.0% ranking in the 14th percentile of the median public fund, and the three-year return of 0.9% ranked in the 52nd percentile. The inception date of this municipal deposit was November 1, 2007; therefore, further performance data was achieved prior to it joining VPIC. Burlington's five-year return of 4.2% was reported in the 67th percentile of the median funds universe.

Mr. Wisloski explained that the lower performance of VSTRS relative to the other three participating plans was due to VSTRS more closely tracking VPIC's policy index, since VSTRS withdraws substantially more cash each month and is effectively "mini-rebalanced" more frequently than the other plans. As such, VSTRS was relatively underweight equities (which performed very strongly during Q4).

<u>ITEM 9:</u> **Asset Allocation Review**

NEPC presented four potential modifications to VPIC's asset allocation:

Mix A (Emerging Theme) – Increases emerging market debt and changes allocation from "external" to "local currency"

Mix B (Inflation Theme) – Increases inflation hedging and reduces economic growth dependent mandates; increases commodities, TIPS and inflation-sensitive global allocation strategy AQR

Mix C – Adds themes of Mix A and Mix B, but also reduces equity and traditional bond mandates further in favor of GAA, hedge funds and real estate

Mix D – Increases hedge funds at the expense of equities, also diversifies Barclays Aggregate into fixed income sub-classes of credit, mortgage-backed, Treasuries and liability-driven investing (LDI)

Mr. Hooper left at 1:30 p.m.

Mr. Jeffrey left at 2:30 p.m.

The Committee planned to examine Mix B, which proposed reducing equities and fixed income each by 2% and increasing commodities and global asset allocation each by 2%. Also, Mr. Rauh and Mr. Wisloski planned to convene with NEPC to discuss the objectives of fixed income in the portfolio and whether these objectives were met using the Barclays Aggregate as a benchmark.

ITEM 10: VPIC Financial Market Dashboard

Mr. Wisloski reviewed the Economic and Financial Markets Dashboard and noted little change from last month: improvements in GDP, payrolls and equity markets continued to be balanced by increasing interest rates and commodity prices, as well as a resumed decline in housing prices. Further, he noted that 2.8% GDP growth represented $420 billion for the $15 trillion U.S. economy and that this growth was occurring at the expense of $600 billion monetary stimulus (QE2) and $1.65 trillion fiscal stimulus via the projected budget deficit (a “return” of less than 20 cents on the dollar). As such, there should be a substantial risk of higher future interest rates, given the government’s large borrowing requirements and prospective end of Treasury securities purchases by the Fed. The Committee held its 12-month forward expectation for GDP constant at 3.5% and for CPI constant at 2.0%.

ITEM 11: Director of Investment and Debt Management Report

Mr. Wisloski reviewed the Director’s report, including further investigation of VPIC’s foreign exchange commissions, monitoring of proposed SEC regulations that could require VPIC members to register as municipal advisors, quarterly and annual total return and alpha attribution by manager, current and projected asset allocation, and updated assets under management. He updated the Committee on plans to recruit a new Director of Investments and provided a brief review of the State Street securities lending program.

ITEM 12: Other or New Business

Given the relatively small balance remaining in the SSgA Russell 2500 fund, the Committee suggested that Mr. Wisloski explore moving that fund from a separate account (which has difficulty tracking the index with less than $10 million invested) to a commingled fund.

The Committee also discussed using iPads or notebook computers as a means of moving toward paperless presentations.

ITEM 13: Adjournment

On a motion by Mr. Mackey, seconded by Mr. Johannesen, the Committee voted unanimously to adjourn at 5:00 p.m.

Respectfully submitted,

Lestyn Mattison, Clerk