

VERMONT PENSION INVESTMENT COMMITTEE
September 25, 2012

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, 2016

DICK JOHANNESSEN, Governor's Delegate, term expiring June 30, 2014

JOSEPH MACKEY, VSTRS Representative, term expiring June 30, 2015

VPIC Member(s) Absent:

STEVEN JEFFREY, VMERS Representative, term expiring June 30, 2014

VPIC Alternate Members Present:

KEVIN GAFFNEY, VSERS *Alternate*, term expiring June 30, 2016 – via telephone

THOMAS GOLONKA, VMERS *Alternate*, term expiring June 30, 2016

THOMAS MCCONNELL, VSTRS *Alternate*, term expiring June 30, 2013

KAREN PAUL, *Alternate* Governor's Delegate, term expiring June 30, 2016

VPIC Alternate Member(s) Absent:

NONE

Also attending:

Stephen Wisloski, Deputy State Treasurer

Matt Considine, CFA, Director of Investments

Katie Green, Investments Manager

Bill Griffin, Attorney General's Office

Richard Charlton, Chris Levell, and Doug Moseley, NEPC LLC

Linda Deliduka, VSTRS Alternate Board Member

Wayne J. Wallace, Executive Director, UBS Realty Investors LLC

Scott A. Brown, Managing Director, Morgan Stanley

CALL TO ORDER:

The Chair, Mr. Rauh, called the Tuesday, September 25, 2012 meeting to order at 8:32 a.m., which was held in the 4th Floor Conference Room, 109 State Street, Montpelier, VT.

**ITEM 1: **Agenda Approval, Announcements, and Minutes of August 28, 2012
Regular Meeting****

The Chair, Mr. Rauh briefly reviewed the agenda and requested any comments. Mr. Mackey asked to attend an endowment forum in Boston.

Mr. Johannesen moved, Mr. Altemus seconded, and the Committee unanimously approved \$1,000 for Mr. Mackey to attend the “Endowment and Foundation Forum” presented by Opal Financial Group on November 12-14 in Boston.

On a motion by Mr. Altemus, seconded by Mr. Mackey, the Committee unanimously approved the minutes of the August 28, 2012, Regular Meeting, as submitted.

(Mr. Wisloski voted as Ms. Pearce’s designee for the above two motions)

ITEM 2: Director of Investments Report and Action Items

(Ms. Paul, Mr. Hooper, and Ms. Pearce joined the meeting)

- **Review of Allianz, AQR and Wellington DAS**
- **Review of Director’s Report**
- **BERS Contract Extension**

Mr. Considine reviewed with the Committee the results of discussions he and Ms. Green held via telephone call with representatives of Allianz and Wellington DAS, and in person with AQR. Mr. Considine indicated that further discussion may be warranted as to whether Allianz belongs in VPIC’s fixed income allocation, given that much of its volatility derives from its alpha (i.e., equity options) as opposed to beta source. Discussions with Wellington DAS gave rise to similar concerns. Wellington DAS also reported changes to its portfolio team, which Mr. Considine believed was a tacit acknowledgement that for a fund-of-funds, the managers’ selection process is a source of alpha. Finally, Mr. Considine reported that AQR indicated that they no longer considered CPI+5% to be a reasonable performance benchmark, given that the forward-looking return expectation for a 60% equity/40% bond portfolio was at its lowest level in a century.

PIMCO was granted permission to hold a downgraded private placement mortgage security that represented 2 basis points of the Core Plus portfolio’s holdings. Overall, the 2.6% of the holdings in both the PIMCO Core Plus and Unconstrained portfolios are below the minimum credit quality ratings.

VPIC’s assets under management were up approximately 1.7% to \$3.55 billion as of August 31, 2012. Mr. Considine indicated VPIC’s total assets under management (AUM) were 1.6% below the October 2007 “high water” mark. Mr. Considine reviewed with the Committee the portfolio asset allocation update indicating as of September 30, 2012 VPIC’s portfolio allocation by major asset class is projected to be 32.9% equities, 35.6% fixed income, 11.3% alternatives and 20.2% multi-strategy, compared to target allocations of 33.5%, 35%, 11.5% and 20% respectively. Mr. Considine explained that overweights to asset classes were due to managers with scheduled (i.e., less than monthly) liquidity for whom a several month lead time was required for rebalancing.

Mr. Wisloski indicated that the Burlington Employees' Retirement System (BERS) voted to extend its contract with VPIC to invest BERS' pension fund assets by one year, to October 31, 2013, and recommended that VPIC execute an amendment to the current contract accordingly.

Mr. Johannesen motioned, Mr. Altemus seconded, and the Committee unanimously voted to extend the contract between VPIC and BERS by one year to October 31, 2013.

ITEM 3: State Treasurer's Report

Ms. Pearce indicated that in conjunction with the preparation for the disclosures for the State's bond sale, she had asked Buck Consultants to perform a "roll-forward" analysis for the State Employees' and Teachers' systems based upon updated asset values and 2011 liabilities; the preliminary estimate was that there was little change to the funded ratios. Ms. Pearce also indicated that Buck needed to perform additional work because of changes to the format of the State's census data due to the conversion to the new pension accounting system. Mr. Rauh proposed moving VPIC's review of the actuarial reports to the November meeting.

ITEM 4: Contract Updates

Ms. Pershing Johnson briefed the Committee on the status of the negotiations with private equity fund-of-funds manager Harbourvest. She indicated the Attorney General's Office's preference to use Harbourvest's onshore legal structure, involving four separate fund investments rather than a single combined fund since VPIC does not require tax preference.

Ms. Pearce motioned, Mr. Mackey seconded, and the Committee unanimously voted to invest in the four separate Harbourvest funds as recommended by NEPC.

ITEM 5: Manager Performance Evaluation

(Mr. Gaffney joined the meeting)

Mr. Moseley reviewed NEPC's presentation entitled "Manager Performance Evaluation," which included performance assessments for each investment manager for up to 5-year periods ending June 30, 2012. In general, traditional long-only managers performed well relative to similar-volatility benchmarks; GAA and Risk Parity managers performed well versus baseline policy benchmarks, hedge fund-of-funds, which have a shorter tenure with VPIC, have had relatively flat performance in line with the industry; and portable alpha managers' results have been mixed, with flat-to-negative performance from Wellington DAS and very volatile performance from Allianz.

Mr. Rauh paused the manager performance discussion, to resume after the scheduled real estate discussion and manager presentations.

ITEM 6: Real Estate Discussion

- **Real Estate Allocation and Pacing Discussion**
- **Presentation by UBS Trumbull Property Fund (UBS-TPF)**
- **Presentation by Morgan Stanley Prime Property Fund**

Mr. Moseley reviewed NEPC's presentation entitled "Real Estate Allocation and Pacing Discussion." VPIC's currently allocation is 4.5%, or approximately \$160 million, allocated 82% to core (i.e., income generating) and 18% to value added (i.e., income plus capital appreciation) strategies; NEPC's recommended allocation is 5.0%, further allocated 60% to core, 30% to value added and opportunistic (i.e., capital appreciation), and 10% to real estate debt (i.e., income plus capital appreciation).

Mr. Mackey stated that he believed long-held attitudes toward real estate were shifting from owning to renting, whether with respect to individuals, or even the federal government leasing properties. Mr. Levell expressed concern that the current generations have as much or more college debt than prior generations had in mortgage debt, and as a result younger people will be priced out of home ownership for the foreseeable future.

Wayne Wallace reviewed VPIC's investment in the UBS-TPF. He said the overall environment is characterized by weak economic growth competing with record low supply, and that the fund is currently oversubscribed with a \$2.5 billion deposit queue. The funds' performance objectives are to exceed the NFI-ODCE ("odyssey") index, and to provide a 5% real rate of return, before fees, over any 3 or 5 year period, which the fund generally has achieved.

(A recess for lunch was taken from 12:15 p.m. to 1:00 p.m.)

Scott Brown reviewed VPIC's investment in the Morgan Stanley Prime Property Fund. He indicated that the fund has outperformed the NFI-ODCE benchmark for 1-year, 3-year, 5-year and 10-year periods ending June 30, 2012, gross of fees.

ITEM 7: Resumption of Manager Performance Evaluation

Mr. Moseley continued the performance review with a discussion of the diversified bonds managers: Allianz, PIMCO Core Plus, PIMCO Unconstrained, and Wellington DAS.

Mr. Moseley suggested inviting Allianz and Wellington DAS for in-person discussions; Mr. Rauh suggested a further data review first, and possibly moving the two managers from diversified bonds and into the multi-strategy allocation.

ITEM 8: Flash Report for Periods Ending August 31, 2012

Mr. Moseley reviewed with the Committee the July Flash Report. VPIC's composite total return for 1 month was 1.3%, year-to-date was 8.6%, prior 12 months was 8.4%, and the

annualized return for 3 years was 10.4%, for 5 years was 2.9%, and for 10 years was 7.4%, in all cases gross of fees. Mr. Considine noted that the Policy targets for Small/Mid Cap Equity should be 6.5% (versus 6.0%) and for Real Estate should be 4.5% (versus 5.0%), based upon changes to VPIC's asset allocation voted upon by the Committee.

ITEM 9: Economic and Financial Markets Dashboard

The Committee discussed the economic and financial market dashboard. The Committee discussed the positive and negative factors on the economic and financial market dashboard. The Committee reviewed the charts on the dashboard.

ITEM 10: Other Discussion Items and Adjournment

Mr. Rauh reiterated that the annual policy review and discussion of portable alpha strategies would be brought forward to the October meeting, and the discussion of the actuarial reports would be moved to the November meeting.

The Chair, Mr. Rauh, declared the meeting adjourned at 3:20 p.m.

Respectfully submitted,

Steve Wisloski, Deputy State Treasurer