

VERMONT PENSION INVESTMENT COMMITTEE
March 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

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

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

JOSEPH MACKEY, VSTRS Representative, term expiring June 30, 2011

VPIC Member(s) Absent:

ROBERT HOOPER, VSERS Representative, term expiring June 30, 2012

VPIC Alternate Members Present:

KEVIN GAFFNEY, VSERS *Alternate*, term expiring June 30, 2012

THOMAS GOLONKA, VMERS *Alternate*, term expiring June 30, 2012

KAREN PAUL, *Alternate* Governor's Delegate, term expiring June 30, 2012

VPIC Alternate Member(s) Absent:

JON HARRIS, VSTRS *Alternate*, term expiring June 30, 2011

Also attending:

Steve Wisloski, Deputy State Treasurer

Monica Chiren, Clerk

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, March 22, 2011 meeting to order at 8:30 a.m., which was held in the 4th Floor Conference Room, 109 State Street, Montpelier, VT.

ITEM 1: **Agenda Approval, Announcements, and Minutes of February 22, 2011 Regular Meeting**

Mr. Wisloski 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. Mr. Rauh, Ms. Pearce, Mr. Mackey and Mr. Wisloski indicated that they plan to attend; Mr. Hooper had previously indicated by e-mail that he plans to attend.

The Committee approved the Agenda.

On a motion by Mr. Altemus, seconded by Mr. Mackey, the Committee unanimously approved the minutes of the February 22, 2011 Regular Meeting.

ITEM 2: Review of Contracts

Ms. Pershing Johnson provided a status update on the contract amendments extending PIMCO All-Asset and Mellon Global Asset Allocation for five (5) years through March 31, 2016: the PIMCO amendment is complete; and one final point is being negotiated with Mellon and is expected to be resolved. Mr. Wisloski reported that the State Street Custody contract needs to be extended for three months for further due diligence regarding custodian fees without securities lending.

On a motion by Mr. Mackey, seconded by Ms. Pearce, the Committee unanimously approved an extension of the State Street Custody contract under the existing terms through June 30, 2011.

Mr. Rauh asked Mr. Wisloski to research moving the SSgA Russell 2500 Index Fund from a separate account to commingled, given the relatively small expected future balances.

ITEM 3: Review of Wellington Conference, Coordination of Future Conferences

Mr. Altemus and Mr. Wisloski reported on their attendance at the March 3 client-only Wellington Compliance Conference in Boston. Both reported that Wellington's attention to all aspects of compliance, including operations, transaction management, contractual review, regulatory oversight, and transition management appeared to be detailed, was well-staffed with very knowledgeable personnel, and of uniformly high quality.

Mr. Wisloski noted that PIMCO is also hosting several client-only conferences, directed toward both staff and board members, in June and September at its headquarters in Newport Beach, California. **Mr. Rauh asked Mr. Wisloski to share the PIMCO agendas and conference details, when available, with VPIC members.**

ITEM 4: Review of Managers on NEPC's Watch List

Mr. Kondry reported that both Acadian (Established International Equity) and Mellon (Global Asset Allocation) had been added to NEPC's watch list. Acadian lost a portfolio manager and a client engagement manager, the latest of several staff departures over the past year. Mellon lost a senior team member critical to developing the current architecture of the GAA strategy. NEPC did not recommend changes at this point.

Mr. Rauh asked Mr. Wisloski to obtain an updated version of Acadian's "factor spread versus alpha" chart.

Ms. Pearce asked that both Acadian and Mellon be kept on meeting agendas until their personnel situations were resolved and they were otherwise removed from NEPC's watch list.

ITEM 5: Review of NEPC Flash Report for February 28

Mr. Kondry reported that total return of VPIC's participating systems was 2.5% to 2.6% for the first two months of the year, compared to 5.9% for the S&P 500 Index and 0.4% for the Barclays Aggregate. In VPIC's portfolio, emerging market equity and global asset allocation underperformed, while fixed income portable alpha and commodities outperformed. Mr. Levell noted that during the decade from 2000 to 2010, mid-cap domestic equity outperformed both large and small cap.

Mr. Johannesen asked Mr. Wisloski if it was possible to determine VPIC's aggregate exposure to various prime brokers.

Ms. Pearce asked Mr. Wisloski to provide a list of the actual dollar amount of fees paid to each manager, inclusive of net fee contracts.

ITEM 6: Asset Allocation Review

Mr. Levell opened the discussion with a review of NEPC's capital market observations for 2011, suggesting that investors face a lower return environment because of record low current bond yields, poor stock fundamentals, and unemployment and debt overhang issues remaining unsolved. General recommendations included (1) illiquid strategies, (2) exposure to emerging market local currency, and (3) hedging against developed market currency risk.

Mr. Johannesen inquired as to whether NEPC or an outside party could conduct an educational session on how the loss of the dollar's reserve status could impact VPIC's portfolio, perhaps by studying what happened when the British pound lost its reserve status to the dollar during and after World War II.

Building upon the presentation from the February 22 meeting, Mr. Levell presented two alternative asset allocations:

Mix A, which reduced large cap and international established equity and core bonds by a total of 9% of the portfolio, added a specific Treasury mandate, and increased emerging market debt, TIPS, real estate, GAA and commodities by a total of 9%. This portfolio would be expected to reduce the equity risk of VPIC's portfolio from 73% to 65%.

Mix B, which reduced equities and increased GAA by 5%. This portfolio would be expected to further reduce the equity risk of VPIC's portfolio to 61%.

After considerable discussion, the Committee decided to postpone adopting changes to the portfolio's asset allocation until the April meeting and instead focus on the portfolio's fixed income allocation.

ITEM 7: Fixed Income Portfolio Discussion

Mr. Levell reviewed the historical and evolving role of fixed income in the overall portfolio, including providing liquidity, income, dampening equity volatility, diversification, total return, and hedging liabilities. He then described a framework for constructing a fixed income portfolio from an asset allocation perspective and listed the short-term goals and objectives of a restructured fixed income portfolio, including:

1. Enhance the expected return and income
2. Reduce exposure to the more interest rate sensitive fixed income sectors
3. Continue to increase diversification by adding exposure to additional asset categories
4. Maintain liquidity and ability to rebalance
5. Increase the ability to be more tactical

Mr. Levell then reviewed PIMCO's Unconstrained Bond Strategy as an alternative or complement to VPIC's current PIMCO Core Plus fixed income portfolio.

Mr. Rauh asked Mr. Kondry to arrange for PIMCO to discuss the Unconstrained Bond Strategy at the April meeting.

Mr. Rauh asked Mr. Levell and Mr. Kondry to propose a plan for adding alternative Treasury beta sources to the Allianz and Wellington portable alpha strategies.

Mr. Rauh asked Mr. Wisloski and Ms. Pershing Johnson to determine whether VPIC could obtain local currency exposure by restructuring the Wellington EMD contract or whether an RFP would be required.

ITEM 8: VPIC Financial Market Dashboard

Mr. Wisloski introduced a revised version of the Economic and Financial Markets Dashboard, which reorganized information and suggested a 12-month outlook – positive, neutral, or negative – for each of VPIC's major asset classes. He also reported that the period since the last meeting had been the most volatile in the past six months, led by the "jasmine revolution" in Middle Eastern countries, most recently Libya, and by the earthquake, tsunami and nuclear crisis in Japan. Based upon increased global uncertainty, the Committee reduced its 12-month forward expectation for U.S. GDP from 3.5% to 3.0%, and, based upon increased food and energy prices, and continued monetary stimulus, increased its CPI expectation from 2.0% to 3.0%.

ITEM 9: Director of Investment and Debt Management Report

Mr. Wisloski reviewed the Director's Report. It appears, based upon guidance from the House Committee on Financial Services to the SEC, that VPIC members will not have to register as municipal advisors unless they are soliciting municipal advisory business. The securities lending program's "breakeven" timeframe – underwater amount divided by projected annual income – improved to 10.5 months from 17.2 months in September 2010. VPIC's asset allocation after the March 31 semiannual rebalancing was projected to be within 0.4% of target allocation in all major asset classes. Finally, VPIC's assets under management increased to \$3.352 billion as of February 28.

Ms. Pearce asked Mr. Wisloski to analyze the impact of the end of QE2 and a housing “double-dip” on the securities lending portfolio.

ITEM 10: Other or New Business

Ms. Pearce asked Mr. Wisloski to analyze whether the VPIC custodian’s foreign exchange transaction fees were reasonable.

ITEM 11: Adjournment

The Committee voted unanimously to adjourn at 4:30 p.m.

Respectfully submitted,

Monica Chiren, Clerk