Investment Advisory Panel Meeting

January 9, 2009
10:00 a.m.
James R. Thompson Center
Chicago, Illinois

Attendees: Andrew Davis
Frank Bello
Kim Lee
Pat Krolak
Debora Calcara

Via Telephone: George Clam
Mike Mann

Absent: Susan Keegan

Mr. Bello opened the meeting asking Mr. Krolak to provide the panel with an update on the current state of the market.

Mr. Krolak then provided a review of the portfolio as of December 31, 2008. He noted that fiscal year to date the fund has $811 million, down 18% for fiscal year to date and relative to where the fund should be pacing. He stated that three of the active managers have been terminated for not performing. Two of the managers, Denver Investment Advisors and Nicholas Applegate were having their contract up soon for renewal but it was necessary to terminate their contract immediately due to their performance in the last 18 months. The third manager terminated was Ernest Partners. Although they were just hired a year ago, in reviewing their underline holdings it was decided to terminate their contract. The holdings managed by these companies have been distributed to other firms on a temporary basis. As a result there is about $40 million additional allocation in the international sector.

Additionally, as a result of Barclay Capital buying out Lehman Brothers index business, the references to the Lehman Aggregate bond index will be Barclay Capital or BarCap.

There has also been an increase in exposure to TIPS in line with the guidelines. The portfolio accounts to about $25 million.

Mr. Bello noted that a quarterly dividend of $56,000 has been received from Shorebank for the private equity holding.

Mr. Krolak noted that they continue to work to the target allocation in the private equity fund. He stated that a large portion of the fund is now passively managed, which is a benefit not only in management, but also in the reduction of fees. He stated that they are also monitoring the emerging and minority investment firms graduating and no longer being emerging firms which Piedmont and Pugh are both on track to do.

Mr. Davis said that he is confident that this is the best team that could have been put together and no sacrifice has been made in hiring emerging or minority firms.

Mr. Bello stated that the asset allocation is about 30% domestic equity, 10% international, 46.2% fixed income and 1.6% private equity.

Responding to Mr. Clam, Mr. Bello noted that in December an RFP was issued for real estate and infrastructure money managers and staff should bring qualified managers to the Commission for approval at the January meeting. He also stated that there should be a private equity and small cap issued in May. Mr. Bello indicated that the Panel should meet again in June to review the asset managers and the asset allocations at that time.

Mr. Bello noted that new operational guidelines had been sent to the panel members this morning, which reflect changes proposed by the bond managers and given the current environment.

Mr. Krolak indicated that a change requested by the managers is to allow managers to add value by going deeper down in the credit quality, into the below investment grade fixed income assets of up to 20% for corporate bonds. He stated that the other main change was in the event that a security gets downgraded to below investment grade, managers should be allowed six months to hold that security rather than require immediate reaction, similar to a sell trigger which results in unnecessary loss for the sake of maintaining credit quality.

Continuing, Mr. Krolak stated that in the past there was an uncertainty about allowing the purchase of 144A securities. He clarified that this purchase is allowed for 529 plans and are now allowing the managers to invest up to 10% in 144A securities.

Another clarification has been made to the guidelines allowing managers to purchase or utilize financial futures for hedging only.

Mr. Krolak confirmed for Mr. Clam that the core bond portfolio is a group rating by weighted average.

Summing the current makeup of managers, Mr. Bello stated that there are two active managers and four passive mandates in domestic equity and in the bond portfolio there are five active managers and one passive index, which is State Street.

Mr. Bello stated that the Commission meeting being held on January 30 would be a required joint meeting of the Investment Advisory Panel and the Commission. Mr. Davis stated that should any member of the panel wish to address the Commission at that time they should feel free to do so. He stated that it is his hope to have a new panel member to bring to the Commission for appointment at the January meeting and hopes to have additional appointments at future meetings until there is a full panel.

In closing, Mr. Davis stated that this is clearly a challenging time to manage assets but feels staff and the managers are up to the task. He stated that the program he and Mr. Bello inherited was in good condition, not withstanding the 18% down fiscal year to date. He feels that the changes being made going forward will put the fund in good stead and thanked Mr. Bello for his efforts in working with Marquette and Associates to make sure the investment managers are sound and up to the challenges ahead. He stated that in order to keep a healthy plan new money should be coming into the portfolio and feels it is a good opportunity to sell new contracts.

Responding to Mr. Clam, Mr. Davis stated that contract sales are running just under last year at this time.

Mr. Davis thanked the panel members for their time and adjourned the meeting at 11:20 a.m.

Respectfully submitted,

Debora A. Calcara

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Secretary to the Commission