

INVESTMENT ADVISORY COUNCIL
WEDNESDAY, September 13, 2006

MEETING NO. 338

Members present:

Thomas Fiore, representing
Robert L. Genuario
David (Duke) Himmelreich
James Larkin
William Murray
Denise L. Nappier, Treasurer
Sharon Palmer
Clarence (Dick) L. Roberts, Jr., Chairman
David Roth
Carol Thomas
Peter Thor

Absent:

Michael Freeman

Others present:

Howard G. Rifkin, Deputy Treasurer
Susan B. Sweeney, Chief Investment Officer
Robyn Belek, Deputy Director of Communication
Tiffany Chan, Research Assistant
Patricia DeMaras, Associate Counsel
Greg Franklin, Assistant Treasurer-Investments
David Holmgren, Principal Investment Officer
David Johnson, Principal Investment Officer
Donald Kirshbaum, Investment Officer
Catherine E. LaMarr, General Counsel
Shelagh McClure, Director of Compliance
Meredith Miller, Assistant Treasurer-Policy
Lee Ann Palladino, Principal Investment Officer
Jason Price, Investment Officer
Linda Tudan, Executive Assistant to the Treasurer
Judy Balich, Executive Secretary

Guests:

Bradley Atkins, Franklin Park, LLC
Laura Backman, State Street Bank
Vonda Brunsting, Service Employees International Union
Raudline Etienne, CRA RogersCasey
Juan Fernandez, Service Employees International Union
Vicki Fuller, Alliance Bernstein
Tom Karoly, CRA RogersCasey
Harvey Kelly, Leumas Advisors
Julie Nauncheck, CSEA-Retiree Council #400
Daniel Schmitz, CRA RogersCasey
Steven Weingarten, Service Employees International Union
Marc Weiss, Pension Consulting Alliance
Thomas Woodruff, Office of the Comptroller
Jamil Zraikat, CRA RogersCasey

Chairman Dick Roberts called the meeting to order at 9:10 A.M.

Approval of Minutes

Chairman Roberts asked for comments on the Minutes of the June 21, 2006 Investment Advisory Council ("IAC") Meeting. There being no comments, **a motion was made by William Murray, seconded by Peter Thor, that the Minutes of the June 21, 2006 IAC meeting be accepted as drafted. The motion was passed unanimously.**

Opening Comments by the Treasurer

Treasurer Denise Nappier began her comments noting that she had a few updates from the May and June meetings to share. She said that after reflecting on the feedback from the IAC and further evaluating the four Core international equities managers that made presentations at the May 10, 2006 IAC meeting, she decided to designate three of the managers, Acadian Asset Management, Inc., AQR Capital Management, LLC and Julius Baer Investment Management, LLC, with preferred manager status, subject to satisfactory contract negotiations. She added that she decided to designate the fourth manager, UBS Global Asset Management ("UBS"), with a conditional preferred manager status. Treasurer Nappier explained that she requested that the consultant, CRA RogersCasey ("CRARC"), scrutinize UBS's performance and fluctuations in asset size for the next several months and issue a final due diligence report by March 2007, at which time she would decide whether to proceed with a final designation and authorize the commencement of contract negotiations.

Treasurer Nappier also announced that after reviewing the IAC's feedback following the presentation by MacFarlane Partners at the June 21, 2006 meeting, she decided to commit \$100 million to MacFarlane Urban Real Estate Fund II, L.P. She noted that this commitment would be subject to satisfactory contract negotiations.

Turning to the agenda for today's meeting, Treasurer Nappier said that several principals of Court Square Capital Partners, II, a private equity limited partnership seeking between \$2.5 billion and \$3.25 billion of capital commitments would be presenting today. She noted that this buyout fund would focus on mature, upper middle market companies in the technology, healthcare, business services, industrial and media sectors. She also noted that the group is a spin out from Citigroup Venture Capital Equity Partners, with an experienced and stable investment team that had generated excellent returns and that she is considering a commitment of up to \$100 million to this fund. Treasurer Nappier said that she would delay the update on the Asset Allocation Subcommittee's work and recent recommendation until the arrival of Raudline Etienne and Tom Karoly of CRARC, who were delayed due to traffic.

Treasurer Nappier said that the preliminary working draft policies for Proxy Voting were provided to the IAC for comments and that Meredith Miller, Assistant Treasurer-Policy Unit, would talk about the preliminary draft later during the meeting. She said that today's informal review was not intended to commence the statutory review and approval process which will occur at the October meeting, or when she presents the recommended draft to the IAC for its official review and recommendation for any changes.

Chairman Roberts noted that the November IAC meeting scheduled for November 8, 2006, is the day after Election Day and suggested that the meeting be changed to the following Wednesday, November 15, 2006. IAC members agreed to change the date from November 8 to November 15, 2006.

Treasurer Nappier directed the IAC's attention to the recent press release dated September 1, 2006 related to recoveries in class action litigation. She advised that the program, which was initiated in the year 2000, recovered just over \$2 million in fiscal year 2006 and nearly \$12 million since inception, and that the money has been recovered with little more effort than briefly reviewing cases and completing the necessary claim forms.

CRPTF Final Performance for July 2006

Susan Sweeney, Chief Investment Officer, said that the last performance report provided to the IAC was for the month of April. She said that since May and June results would be reflected in the fiscal year end commentary from CRARC later during the meeting, she would offer a few comments on fiscal 2006 and TUCs results before turning to July performance.

Ms. Sweeney reported that the Connecticut Retirement Plans and Trust Fund ("CRPTF") returned 10.91% for fiscal year 2006, net of all fees and expenses, exceeding the benchmark by 90 basis points without the manager objective, and trailing by 56 basis points with the manager objective added in. She reported that for the seven years ended June 30, 2006, the fund outperformed its benchmark by 156 basis points without the manager objective and 16 basis points with the manager objective added in. Ms. Sweeney also reported that in the liquid asset classes, domestic and international equities outperformed their respective benchmarks by 130 and 124 basis points, and fixed income trailed its custom benchmark by 59 basis points but exceeded the Lehman Brothers Aggregate ("LBA") by 30 basis points. She noted that the Private Equity and Real Estate Funds have lagged the industry performance as the Fund has worked through some legacy problem investments and in only the last few years has re-entered the market under the direction of the Treasurer and the guidance of the IAC.

Ms. Sweeney reported that within the TUCs universe of public funds greater than \$1 billion, the CRPTF ranked at the 42nd percentile for the fiscal year. She noted that the three month and one year rankings could fluctuate widely, so it is important to look at the longer term performance. Ms. Sweeney said that for the seven years ended June 30, the CRPTF ranked at the 29th percentile among the peer group, with a risk rank at the 81st percentile, which reflects that Connecticut outperformed 71% of the funds in the universe, while assuming less risk than 81% of them. She added that over the ten year period ended June 30, the Fund has achieved an 8.83% annualized return, exceeding its actuarial target of 8.5%.

Ms. Sweeney reported that for the new fiscal year, the Fund returned 0.49% in July, a modest 7 basis points behind its benchmark return and the trailing year performance was 133 basis points ahead of the benchmark with a return of 9.02% versus a 7.69% return for the benchmark. She said that as of July 31, 2006 CRPTF's total market value stood at \$23.0 billion, with the Fund's equity exposure at 62.4%.

Ms. Sweeney said that the Mutual Equity Fund (“MEF”) fell a modest 0.33% during July, 24 basis points behind the Russell 3000 benchmark, but that for the past seven years, the MEF has annualized 3.29%, nicely outperforming the Russell 3000 by 120 basis points annualized and the S&P 500 by an impressive 228 basis points annualized. She reported that the International Stock Fund (“ISF”) gained 1.06% during July, trailing its customized benchmark by 48 basis points, but that for the seven-year period, the ISF has gained 8.31% outperforming its benchmark by 159 basis points. Ms. Sweeney noted that the Mutual Fixed Income Fund (“MFIF”) returned 1.32% in July, 46 basis points ahead of its custom benchmark and 3 basis points behind the LBA and that over the past seven years, the fixed income portfolio posted an annualized return of 6.34%, 53 basis points below its custom benchmark and 29 basis points ahead of the LBA. Ms. Sweeney indicated that the month of July saw very little activity for the real estate and private equity portfolios. She said that the Cash Reserve Account exceeded its benchmark by 4 basis points for the month of July and 39 basis points for the trailing year.

Asset Allocation Subcommittee Update

Treasurer Nappier reported on the executive summary of the Asset Allocation Study which was discussed at the August 30, 2006 meeting of the IAC Asset Allocation Subcommittee. This document, she noted, reviews the liabilities and cash flow needs of the five pension plans in the CRPTF, including Teachers, State Employees, Municipal Employees, Judges and Probate Judges. She also noted that the Subcommittee has yet to address the various trust funds that comprise about \$110 million of assets, or 0.5% of the total CRPTF, and that CRARC is working with the Office of the Treasurer (“OTT”) on the completion of that phase of the project.

During her overview of the report, Treasurer Nappier talked about the substantially under-funded Teachers and State Employees plans that must sustain high net cash outflows for benefit payments. She noted that these two plans together represent 92% or \$21 billion of the \$23 billion of assets of the CRPTF and that the other three plans range from slightly under-funded to over-funded, and in aggregate represent about \$1.7 billion of assets, which is about 7½% of the total Fund.

Treasurer Nappier explained the model portfolios, as shown on page 7 of the report noting that Portfolio A was the lowest volatility, lowest returning portfolio with an allocation of just 28% to equities and 55% to fixed income; Portfolios B and C have higher expected returns than A but maintain moderate volatility; and Portfolios D and E represent slightly higher returns with the commensurate higher volatility. She said that the major decision from the Subcommittee meeting on August 30 was to proceed with portfolio B/C for the better-funded plans, namely the Municipal, Judges and Probate Judges, and to proceed with portfolio D/E for the two large funds, Teachers and State Employees. Carol Thomas made the point that B/C are a pair and D/E are a pair and that C and E provide the ability for alternative investments. Treasurer Nappier thanked Ms. Thomas and elaborated on this point.

Treasurer Nappier said that the CRPTF is moving toward a more tailored approach to asset allocation that is driven by the unique liabilities of each plan, and that while she has fiduciary responsibility for the CRPTF, it is not a single entity with a single set of constraints and characteristics. She remarked that the changes the subcommittee is recommending are an important step towards recognizing the divergent needs of the plans that entrust their assets to the

OTT and that this recommendation will be formalized through a number of changes to the Investment Policy Statement, which will be presented at a future meeting of the IAC. Treasurer Nappier said that comments and questions from the IAC members on the recommendation are welcomed.

The IAC members had questions and comments regarding the amount of equities exposure, volatility and risk exposure, alternative investments, the logistics of tailoring the asset allocation for each plan, and a cash reserve liquidity fund. There was much discussion on the various topics.

In response to a question, Treasurer Nappier explained that the next steps moving forward in the process would be to receive indication from the IAC that they are in agreement with the direction she is recommending in concurrence with the subcommittee; define all asset classes in writing, including alternative investments; and begin the statutory approval process.

A motion was made by Mr. Roth, second by James Larkin that the Investment Advisory Council agreed to move forward with the recommendation of the Asset Allocation Subcommittee. The motion was passed unanimously.

Presentation by Court Square Capital Partners II, L.P.

Jason Price, Investment Officer, said that there were highlights of Court Square Capital Partners II, L.P. (Court Square II) that he would like to add to Treasurer Nappier's introductory remarks. Mr. Price said that Court Square Capital Partners ("Court Square") is one of the most experienced private equity teams in the market today and has a very impressive track record. He noted that its first fund was a \$2.6 billion fund that has invested \$1.8 billion of committed capital, distributed \$2.3 billion to its LPs and has an unrealized portfolio value of \$1.2 billion.

Mr. Roth inquired about the firm's management succession plans, given the tenure of the firm. Bradley Atkins of Franklin Park responded to the question providing more information regarding the steps the firm has taken to ensure that younger members of the management team are brought into the partnership.

Presentation by Court Square Capital Partners

Court Square Capital Partners made a presentation to the IAC on Court Square II. Court Square II was represented by Managing Partner David Thomas and Partners Charles Corpening and John Kim. Mr. Thomas provided a profile of the firm, the firm's investment strategy, the investment experience of the firm's investment professionals, and a Fund I portfolio summary. Mr. Corpening spoke about Court Square's commitment to diversity and provided a case study of one of the investments in Fund I. Mr. Kim explained Court Square's dedication and involvement as good corporate citizens.

Throughout the presentation by Court Square, IAC members posed questions regarding the number of seats held by Court Square on ERICO's board; what percentage of investment success was due to buying right and what percentage was due to financial engineering; the reason for the historical number of deals while at Citigroup that generated losses; total number of investors and

number of public fund investors in Court Square 2; the lack of financial support for the Robert Toigo Foundation; and the MSX Corporation. Each question was answered in detail by Messrs. Thomas, Corpening or Kim.

Roll Call of Reactions for Court Square Capital Partners II, L.P.

Peter Thor said that he was impressed with Court Square's presentation and he would vote yes for the investment. Sharon Palmer said that she was fine with the investment. Mr. Roth said that he liked Court Square's theory of buying, its practice of not over leveraging, its track record and as long as it has continued continuity, would vote yes for the investment. Ms. Thomas said that she agreed. Chairman Roberts said that he thought Court Square was a very solid company and supported the investment. Mr. Larkin said that he thought it was a very good fit for the CRPTF. Mr. Murray said that he supported the investment. Duke Himmelreich said that he thought it was a good fit, but hoped that Court Square could increase returns by going out of the "total return" system they used previously. He also thought Court Square was more of a start up firm, but would still support the investment. Thomas Fiore was impressed after reading the report from Franklin Park, as well as with the presentation today and the firm's performance and was fine with the investment.

Chairman Roberts asked for a motion to waive the 45-day comment period for Court Square Capital Partners II, L.P. **A motion was made by Ms. Thomas, seconded by Mr. Himmelreich to waive the 45-day comment period for Court Square Capital Partners II, L.P. The motion was passed unanimously.**

Combined Investment Funds Review as of June 30, 2005

Ms. Etienne reported on the Combined Investment Funds as of June 30, 2006. Before beginning her comments on the fiscal year, she noted that the second quarter was a quite volatile time for the capital markets and many of the major indices posted negative results. Her report for the fiscal year ending June 30, 2006 included an overview of capital markets and commented that all the major asset classes, with the exception of fixed income, were in positive territory. Ms. Etienne said that although she would not report specifically on the Private Equity and Real Estate Funds, they performed very well and that the allocation to those funds would have an impact on the CRPTF's overall performance. Treasurer Nappier commented that the OTT made a conscious decision to not actively invest in private equity for about three years because CRPTF was over exposed to private equity and was aware, based on the pacing study, that CRPTF would be below the 11% asset allocation at this time. Ms. Etienne's report included information on the CRPTF Fund performance for liquid assets including the MEF, the ISF and the MFIF for the fiscal year end as well as the seven- and ten-year results. Ms. Etienne reported that the Fund returned 10.9% net of fees exceeding the 8.5% actuarial assumption and also marking the third consecutive fiscal year of double-digit returns for the total Fund. She said that with regard to the performance of liquid funds, both MEF and MFIF added value to their benchmarks and that although the ISF underperformed its benchmark for the fiscal year, it returned 25.8%.

Connecticut Horizon Fund Review as of June 30, 2006

David Holmgren, Principal Investment Officer, reported on the performance of the Connecticut Horizon Fund (“CHF”) for the quarter ending June 30, 2006. He reported that CHF posted a 2.88% loss for the quarter, but a gain of 7.46% since its inception in September 2005. Mr. Holmgren noted that the current value of CHF is \$463.3 million, diversified across four fund-of-funds managers, with a total of 26 sub-managers and 30 mandates covering 10 asset classes. His report included a manager analysis and commentary for each of the four fund-of-funds managers.

Private Investment Fund Review as of March 31, 2006

Mr. Atkins reported on the Private Investment Fund (“PIF”) for the quarter ending March 31, 2006. His report consisted of an executive summary that included a portfolio overview, benchmark performance, portfolio investment activity including recent commitments and current allocation and performance analysis since inception of the PIF. Treasurer Nappier asked Mr. Atkins to differentiate in some way on the Performance Analysis chart, the PIF investments that are no longer in the portfolio, due to sale or termination. Mr. Atkins said that he would do that going forward.

Real Estate Fund Review as of March 31, 2006

Marc Weiss of Pension Consulting Alliance reported on the Real Estate Fund (“REF”) as of March 31, 2006. His report included a review of the fund’s overall performance, highlights of the first quarter performance, one-year and long-term performance. Mr. Weiss also reviewed investment guidelines, the portfolio diversification and unfunded commitments. Following his report, there were discussions relative to the REF’s overweight in the Southeast region and overweight in the hotel sector. There was a lengthy discussion regarding funding of commitments, with specific emphasis on New Boston Urban Strategy America Fund and the AEW Core Separate Account.

Short-Term Investment Fund Review as of June 30, 2006

Lee Ann Palladino, Principal Investment Officer, reported on the performance of the Short Term Investment Fund (“STIF”) for the quarter and year ending June 30, 2006. Her report included an economic update with snapshots on the Gross Domestic Product, existing home sales, new home sales and crude oil price per barrel and an outlook for fiscal year 2007. Ms. Palladino reported on the performance of STIF for the fiscal year end, noting that, operating in an environment of a growing economy and rising interest rates, STIF had a record performing year. STIF assets hit an all time high of \$6.3 billion, returned 4.38%, outperforming its benchmark, the MFR Index, by 37 basis points, and returned a record amount of incremental income to its investors of \$18.3 million. STIF also increased its safety and soundness by making a record contribution to its reserves of \$3.8 million, bringing total reserves to \$47 million.

Treasurer Nappier said that recent surveys of local government investment pools throughout the country ranked Connecticut’s STIF as number one. She said that this is a reflection of Ms. Palladino’s stellar performance. Treasurer Nappier informed the IAC that the OTT has moved forward with a medium term investment fund, which is allowed by state statute and that it may be considered for the CRPTF following ample time to review its performance.

Proxy Voting Guidelines

Ms. Miller presented a preliminary working draft of the Domestic Proxy Voting Policies. She noted that the changes were drafted to reflect new issues of priority to the CRPTF and new laws passed since the policies were last updated and endorsed by the IAC in March 2000. There was a discussion regarding the preliminary working draft and the IAC members were asked to submit their comments to Ms. Miller by September 20, 2006.

Other Business

Review of the IAC Budget for the fiscal year ending June 30, 2006

Ms. Sweeney reported that the IAC is slightly over budget for commuter costs and meeting costs due to the additional meetings for the Asset Allocation Subcommittee and that education/travel is well under budget.

Pension Funds Management Division's Operating Results as of June 30, 2006

Ms. Sweeney reported that standard fund financials for the fiscal year ending June 30, 2006 are included in the package of materials. She commented that the total fund was approximately \$22.8 billion with a total of \$819 million in investment income offset by \$802 million in distributions.

Status Report on Requests by IAC Members

Ms. Sweeney said that she is working with Treasurer Nappier on the **Staffing Support** update, which is the one remaining request on the status report.

Discussion of preliminary agenda for October 11, 2006 IAC meeting

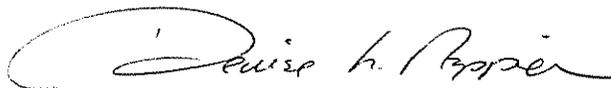
Ms. Sweeney indicated that agenda items would include proxy voting policies, up to three proxy voting/corporate governance vendor presentations, presentations by a real estate opportunity and possibly a private equity opportunity and quarterly reports on cash flow, corporate governance, watch list and securities lending.

Ms. Sweeney noted that IAC members are invited to attend the MEF structure meeting on Friday, September 29, 2006 at 1:00. She also reminded members that the November meeting would take place on Wednesday, November 15, 2006.

There being no further business, the meeting was adjourned at 12:30 PM.

An audio tape of this meeting was recorded.

Respectfully submitted,



**DENISE L. NAPPIER
SECRETARY**