INVESTMENT ADVISORY COUNCIL
WEDNESDAY, February 11, 2009

MEETING NO. 363

Members present:	Thomas Barnes Thomas Fiore, representing Robert Genuario Michael Freeman David (Duke) Himmelreich[1] James Larkin, Chairman Stanley (Bud) Morten William Murray Sharon Palmer David Roth Peter Thor
Absent:	Denise L. Nappier, Treasurer Carol Thomas
Others present:	Howard G. Rifkin, Deputy Treasurer Linda Hershman, Assistant Deputy Treasurer/Chief of Staff Lee Ann Palladino, Acting Chief Investment Officer Joanne Dombrosky, Principal Investment Officer Gregory Franklin, Assistant Treasurer-Investments David Holmgren, Principal Investment Officer Wayne Hypolite, Executive Assistant David Johnson, Principal Investment Officer Catherine LaMarr, General Counsel Shelagh McClure, Director of Compliance Meredith Miller, Assistant Tresurer-Policy Jason Price, Principal Investment Officer Linda Tudan, Chief Executive Assistant Winifred (Winnie) Scalora, Administrative Assistant
Guests:	Bradley Atkins, Franklin Park Joseph Barcic, Mercer Investment Consulting Scott Booth, The Townsend Group Steven Case, Mercer Investment Consulting Ravi Chachra, Eight Capital Jaeson Dubrovay, New England Pension Consultants Louis Finney, Mercer Investment Consulting via telephone David Gabrielson, Ounavarra Capital Llc.

[1] Arrived at 9:09 a.m.

Harvey Kelly, Leumas Advisors
Lou Laccavole, Teachers Retirement Board
Jacqueline Lyons, State Street Bank & Trust
John Minahan, New England Pension Consultants
Julie Naunchek, CSEA-Retiree Council #400
Donn Renert, Sciens Capital Management
Joseph Roxe, Baye Holdings LLC
Johnson Shum, State Street Bank & Trust
Cynthia Steer, Rogerscasey

With a quorum present, Chairman Larkin called the Investment Advisory Council ("IAC") meeting to order at 9:00 a.m.

Approval of Minutes of the December 10, 2008 IAC Meeting

Chairman Larkin asked for comments on the Minutes of the December 10, 2008 IAC meeting. **There being no comments, a motion was made by Peter Thor, seconded by William Murray, that the Minutes of the December 10, 2008 IAC meeting be accepted as drafted. The motion was passed unanimously.**

Opening Comments

Lee Ann Palladino, Acting Chief Investment Officer, introduced the newest member of the Mercer Investment Consultant team, Steven Case. She said that Mr. Case would join Joseph Barcic as co-lead and that he replaced Rich Nuzum, who was promoted within Mercer. Mr. Case briefly addressed the IAC and while commenting on his background, he stated that he worked with the Office of the Treasurer ("OTT") when he was at Rogerscasey and that he looked forward to working with the OTT again.

CRPTF Final Performance for the Months of November and December, 2008 and PFM's Operating Results for the Quarter ended September 30, 2008

Ms. Palladino provided a report on the December 31, 2008 performance results for all 14 of the Connecticut Retirement Plans and Trust Funds ("CRPTF"). She commented that 2008 would be considered a year for the record books due to the financial distress across most asset classes. Ms. Palladino reported that the market volatility contributed to the CRPTF's loss of about 25% of its market value during 2008.

Ms. Palladino stated that there were three critical events that would continue to impact the CRPTF throughout 2009. She said that the first of these critical events was the credit crisis, the second was the global recession and the third critical element, a positive one, was the fact that the U.S., as well as other governments throughout the world, were creating intervention programs to help stabilize the market, build confidence and return the markets to normalcy.

Ms. Palladino discussed, in detail, the housing market commenting on sales, market price declines and delinquency ratios. She concluded that there was still too much uncertainty in the housing market to forecast the 2009 calendar year outlook and how it might affect performance. Ms. Palladino noted that this not only affected the fixed income markets, but that the credit crisis affected all asset classes.

Regarding the economic outlook, according to the Bloomberg Economist forecast for the U.S. in 2009, Ms. Palladino commented that the GDP would be down 1.5% with recovery expected to occur in the second half of 2009 and into 2010. She added that a recessionary environment would be present for the entire 2009 fiscal year. Ms. Palladino then stated that the world-wide growth should expand at 50 basis points ("bps") during 2009 and that the emerging markets, which grew about 6.25% in 2008, were expected to grow about 3.25% in 2009.

Ms. Palladino then provided an overview of the tactical allocation for all CRPTF asset classes. She commented on the performance for all 14 plans and trusts describing the difference in performance versus the asset allocation for each fund over the fiscal year, calendar year 2008 and the longer term seven-year horizon. She summarized by stating that 2008 was not a year where diversification was helpful.

Ms. Palladino then provided the Pension Fund Management Division's ("PFM") Operating Results for the quarter ended September 30, 2008. She stated that the portfolio fell to $20.2 billion as of December 31, 2008 and dropped further to $19.7 billion as of early February 2009. Ms. Palladino noted that the unrealized loss of all of the securities as of September 30, 2008 was $2.1 billion with realized losses of $323 million. She also commented on securities lending, which showed income of $6.4 million.

Ms. Palladino addressed Mr. Roth's questions regarding the length of time for money manager searches and the need to be flexible. Deputy Treasurer Rifkin added that public funds did have procedural and transparency requirements.

<u>Consideration of the Treasurer's Adopted Revisions to the Investment Policy Statement</u>

Chairman Larkin stated that the revisions to the Investment Policy Statement ("IPS"), to set forth guidelines for the CRPTF's new Alternative Investment Fund, as presented at the December 10, 2008 IAC meeting, needed to be considered for approval by the IAC. He also stated that only public members of the IAC could be included in the vote. Chairman Larkin asked if any of the IAC members had questions or issues with the final changes to the IPS.

Chairman Larkin then asked for a motion to approve the Treasurer's adopted revisions to the IPS. David Himmelreich entered a motion to approve these adopted revisions. Michael Freeman seconded the motion. The motion was passed unanimously to approve the revisions to the IPS as adopted by Treasurer Denise Nappier by all present. There were 9 Yeas , 0 Nays and 1 Absent Not Voting.

Asset Allocation Assumption Review

Lee Ann Palladino, Acting Chief Investment Officer, led a discussion and provided an overview on the Asset Allocation Assumption Review. She first introduced the participants in today's presentation. Ms. Palladino stated that, via telephone, Louis Finney, Ph.D of Mercer, head of capital markets research specializing in asset allocation as well as asset and liability modeling, would participate along with John Minahan, Ph.D., CFA of NEPC, who was responsible for assisting the asset allocation and research committees and assisting clients with asset allocation and risk budgeting models. Ms. Palladino stated that both Drs. Finney and Minahan would provide an overview on Modern Portfolio Theory ("MPT") followed by a discussion on current capital market assumptions and the drivers of performance. She also stated that Cynthia Steer, Managing Director and Chief Research Strategist of Rogerscasey, also assisted in providing institutional knowledge and insight and that Ms. Steer would be available for questions. Ms. Palladino said that Dr. Finney would discuss the traditional asset classes and Dr. Minahan would discuss the alternative asset classes and their forecasts would be compared and contrasted between Mercer, NEPC and Rogerscasey.

Ms. Palladino stated that there were three potential outcomes as a result of the Asset Allocation Assumption Review: 1) Engagement in a new asset and liability study, 2) revision of the capital market assumptions or 3) validation of the existing market assumptions. Her conclusion was that the existing market assumptions could be validated but additional scenario analysis on risks and returns for the CRPTF were also necessary. Ms. Palladino said that the use of MPT, as a tool, worked well providing broad estimates for return and risk but it did have limitations. She explained that Mercer concluded that the modeling risk in MPT was captured on a one-dimensional basis and risk was a multi-dimensional factor, not properly capturing liquidity risk, interest rate risk or nonlinear distributions. She further commented that with regard to MPT, NEPC believed that volatility doesn't mean risk, so the scenarios when money was lost needed to be considered most. However, she added that both Mercer and NEPC would state that liquidity risk was the biggest risk that was not properly captured in MPT. Finally, Ms. Palladino said that Mercer and NEPC would demonstrate that the long-term market assumptions were valid with expected returns of 8.2% to 9.1%, which was the average of where the modeling assumptions were in 2007.

Ms. Palladino then commented on the last Asset Liability Study and said that at that time, it was determined that the asset allocation was customized for each individual Plan and Trust, recognizing that each Plan or Trust was multi-dimensional. She also stated that during that Asset Liability Study, the Core was first modeled, liquidity was layered onto the asset allocation and this assessment of liquidity recognized and addressed one of the limitations of MPT. In conclusion, Ms. Palladino stated that it was recognized that MPT has limitations, new projections by two consultants validated the capital market assumptions going forward, but that scenario testing and risk management oversight should be developed to augment the current asset allocation process. She then commented on changes in the liabilities and the asset allocation for the State Employees' Retirement Fund ("SERF") and the Teachers' Retirement Fund ("TERF"), and that the

Rogerscasey asset allocation model, used as part of the Asset Liability Study, did anticipate scenarios where the level of market decline experienced in 2008 was considered.

Drs. Finney and Minahan shared their thoughts on MPT in a comprehensive PowerPoint presentation about the Asset Allocation Assumption Review.

Dr. Finney provided an overview on setting return and risk assumptions over the long run for the broad asset classes. He stated that there were three main drivers of the capital markets including inflation, economic growth and interest rates. Dr. Finney stated that three theories about equity valuation were all complementary and they included Risk Premium, Dividend Discount Model ("DDM") and Replacement Cost. He explained the DDM model in depth and then compared the historical expected equity returns with Mercer's expected returns. Finally, he commented on the theoretical constraints on interest rates, adjusting current yields and setting volatility and correlation. Dr. Finney then commented on Mercer's October 2008 assumptions for 20-year projected returns.

Dr. Minahan provided the asset class assumptions for Rogerscasey used during the Asset Liability Study and currently for Mercer and NEPC explaining their differences. He noted the validation of the CRPTF's asset allocation using today's assumptions was then provided with comments on the expected return and standard deviation. Finally, Dr. Minahan concluded that the CRPTF's targeted asset allocation had a long-term compounded expected return of 9.7%, and that expected return was the mid-point of the probability distribution.

Several questions were posed by IAC members regarding risk adjusted returns and it was noted that investors must always be prepared for the possibility of loss and that there was always a degree of estimation in predicting the future no matter how sophisticated the forecasting methods. Discussion ensued about whether this model for prediction was used properly to assess risk, what else could have been done to enhance the accuracy of projections and whether or not this down turn could have been avoided to some degree. All agreed that the key assumptions needed to be monitored on a regular basis. Deputy Treasurer Rifkin noted that one of the challenges of the entire capital market structure was the question, "How is risk determined?" In order to do any projection, he said that you still must, in part, rely on what happened historically.

Mr. Barcic provided the results of the 1970s Backtest along with a comparison between what transpired in the country and in the markets during 1974 versus 2009. He then provided an executive summary on Backtesting between 1973 and 1982 using the current portfolio. Mr. Barcic stated that the CRPTF was within the 18 ½% target range given all the assumptions.

<u>Update on CRPTF Cash Flow</u>

Gregory Franklin, Assistant Treasurer-PFM, reported on the CRPTF cash flow through June 30, 2008 with projections for the 2009 fiscal year. He first presented an overview on the process of calculating and managing cash flow for the CRPTF. Mr. Franklin stated that there was adequate cash and the decision to increase the Liquidity Fund's targets to 1.5 times benefit payments proved to be prudent in view of the current market crises. He then provided detailed cash flow reports and projections for the TERF and SERF.

Real Estate Fund Review as of September 30, 2008

Scott Booth, Vice President of The Townsend Group, presented the Real Estate Fund ("REF") report for the quarter ended September 30, 2008. He reported that the REF's quarterly return was at negative 6% on a gross basis and negative 6.2% on a net basis underperforming the NCREIF Property Index ("NCREIF") by 6% predominantly due to beginnings of mark-to-market write downs. Mr. Booth stated that the portfolio produced an 8.6% net return for the three-year period underperforming its benchmark by 230 bps. For the five-year period, the portfolio produced a 12.3% net return beating its benchmark by 10 bps. Regarding performance and attribution, he commented that the total CRPTF portfolio leverage was 43.1%, which was a prudent and somewhat conservative level, but the program was at risk of underperformance to the benchmark, an unleveraged index, during the current down cycle. Mr. Booth stated that core investments, which represented 45% of the portfolio, had an overall appropriate risk profile compared to the objective, and was conservative relative to peers. He added that the non-core items in the portfolio were the value-add components at 16% and the opportunistic component comprising 39% of the overall program as of the third quarter. Mr. Booth ended by reporting on the performance of the various funds within the REF.

Mr. Booth responded to Mr. Roth's questions regarding new investments during 2009 by stating that transaction volume was down but investments would be in the opportunistic arena once credit became available to investors. Mr. Morten suggested using other benchmarks besides, or in addition to, the NCREIF and Mr. Booth commented on the other benchmarks. Further discussion ensued about balancing the REF and investing during difficult economic times.

Private Investment Fund Review as of September 30, 2008

Bradley Atkins, Chief Executive Officer of Franklin Park, presented the Private Investment Fund ("PIF") report for the quarter ended September 30, 2008. Mr. Atkins first stated that the portfolio earned about 8.4% net IRR since inception above the public benchmark by 570 bps. For the one-year return through September 30, 2008, he reported that the portfolio was down 2.2%; but relative to peers who averaged a 10% loss and versus the S&P 500 Public Market Equivalent, which was down 18.2%, the portfolio actually did well. Regarding commitments made between 2004 and 2008, Mr. Atkins reported a 10% markdown for this quarter, but added that the broader industry was at negative 15% to 20%. He then commented on the Fund-of-Funds for the quarter and the Vintage Year 2008 Funds noting mixed returns.

Regarding year-to-date commitments made over the last 12 months, Mr. Atkins stated that close to $600 million had been committed, which was close to the plan put in place and included the Connecticut Horizon Fund commitments. On an asset allocation basis, he reported that the PIF was at 7.1% of current CRPTF assets, still below the 11% policy target for the portfolio. Regarding annual cash flow trends, Mr. Atkins stated that the current trend showed more cash going out than coming in with the pacing of investment and distributions slowing down and he added that this trend would probably continue through 2009.

In response to Mr. Morton's comments and questions about picking first quartile versus fourth quartile managers, Mr. Atkins stated that it was a priority for the private equity program to be structured in such a way that the very best managers would be identified and accessed. He further noted that it was important to be equal weighted by vintage year with constraints in place to mitigate overexposure to any one market segment and beyond that the goal was to pick the best managers. Mr. Atkins ended by commenting that there was opportunity in the turnaround, buyout and distressed debt spaces.

Securities Lending Review as of December 31, 2008

Johnson Shum, Vice President of State Street Bank & Trust ("State Street"), provided a report on the securities lending activity for the quarter ended December 31, 2008. He began by providing general comments on the impact of recent market events on securities lending.

Mr. Shum then provided the performance results for fiscal years 2007, 2008 and through the first half of 2009. Mr. Shum stated that earnings increased $19.1 million during the first half of the 2009 fiscal year and increased 86% over the same period last year. He then reported that during 2008, all assets earned $21 million over the 2007 fiscal year. Mr. Shum then provided a program summary on the top 10 borrowers as of December 31, 2008. Mr. Shum provided a snapshot of the State of Connecticut Collateral Investment Fund as of December 31, 2008. Finally, he provided a sector breakdown for global collateral management as of December 31, 2008 and a yield performance summary from August 2007 through December 2008. Mr. Shum responded satisfactorily to a question from Mr. Morten regarding the recall of securities.

Corporate Governance and MacBride Compliance

Meredith Miller, Assistant Treasurer, Policy, provided a report on Corporate Governance and MacBride Compliance for the quarter ended September 30, 2008. With respect to domestic proxies, Ms. Miller reported that 590 of the proxy issues were cast of which 33.2% were voted against management. For the international proxies, she stated that 117 votes were cast with 8.9% against management so the review of international investment managers resulted in full compliance with the proxy voting guidelines. Ms. Miller stated that 14 primary and eight co-file resolutions were filed. Regarding the federal regulatory reform efforts, Ms. Miller stated that there was now the ability for deliberating within the institutional community about what kinds of reforms would be beneficial. Regarding executive compensation, she mentioned President Obama's new provisions regarding the Troubled Asset Relief Program ("TARP") money and noted the signal for change and widespread curbs on executive compensation including a say on pay.

Regarding the MacBride Compliance, Ms. Miller reported that there was full compliance by all domestic and fixed income managers. Ms. Miller addressed Mr. Roth's question about the policy for ratifying auditors, by stating that the percentage for non-audit work was in question.

Other Business

IAC Budget for the 2009 Fiscal Year
Chairman Larkin reported on the IAC budget for the quarter ended September 30, 2008. He stated that the IAC was under budget as of September 30, 2008. Discussion ensued about whether or not travel was permitted during the current fiscal year.

Revised IAC Meeting Schedule for 2009 Calendar Year
Chairman Larkin stated that the IAC Meeting Schedule for the 2009 Calendar Year had to be revised. He said that Wednesday, November 11, 2009, Veterans' Day, was a state observed holiday so that month's meeting would be held on Tuesday, November 10, 2009.

Discussion of preliminary agenda for the March 11, 2009 IAC meeting
Chairman Larkin invited IAC members to submit agenda items for the March 11, 2009 meeting. Mr. Himmelreich stated that he would present a brief report by the Audit Committee regarding his meeting with Treasurer Nappier and Ms. Palladino at the March 11th meeting.

Comments by the Chairman

Chairman Larkin commented on today's meeting and noted that the discussion about the Asset Allocation Assumption Review was very helpful. He further noted the importance of further discussion about assessing risk. Chairman Larkin agreed with Mr. Morten that reviewing and/or modifying the assumptions was also important.

There being no further business, the meeting was adjourned at 12:55 p.m.

An audio tape of this meeting was recorded.

Respectfully submitted,

HOWARD G. RIFKIN, DEPUTY TREASURER
for
DENISE L. NAPPIER, SECRETARY

Reviewed by

JAMES T. LARKIN
CHAIRMAN