INVESTMENT ADVISORY COUNCIL
Wednesday, December 9, 2009

MEETING NO. 372

Members present:	Thomas Fiore, representing Robert Genuario David (Duke) Himmelreich Stanley (Bud) Morten William Murray Denise L. Nappier, Treasurer Sharon Palmer* David Roth Joseph (Joe) D. Roxe, Chairman Carol Thomas Peter Thor**
Absent:	Thomas Barnes Michael Freeman
Others present:	Howard G. Rifkin, Deputy Treasurer Linda Hershman, Assistant Deputy Treasurer/Chief of Staff M. Timothy (Tim) Corbett, Chief Investment Officer Lee Ann Palladino, Deputy Chief Investment Officer Wayne Hypolite, Executive Assistant David Johnson, Principal Investment Officer Catherine LaMarr, General Counsel Shelagh McClure, Director of Compliance Meredith Miller, Assistant Treasurer-Policy Linda Tudan, Executive Assistant Winifred (Winnie) Scalora, Administrative Assistant
Guests:	Bradley Atkins, Franklin Park Associates, LLC Joseph Barcic, Mercer Investment Consulting Scott Booth, The Townsend Group Charles Colfer, Rogerscasey Jaeson Dubrovay, New England Pension Consultants Seth Hannant, Rogerscasey Rashid Hassan, Mercer Investment Consulting Harvey Kelly, Leumas Advisors Alan Kosan, Rogerscasey Tomas Kukla, Rogerscasey Louis Laccavole, SOC Teachers' Retirement Board Cynthia Steer, Rogerscasey Dominic Williams, Service Employees International Union

***Arrived at 10:33 a.m.**
****Arrived at 10:40 a.m.**

With a quorum present, Chairman Joseph Roxe called the Investment Advisory Council ("IAC") meeting to order at 10:31 a.m. He commended all present for attending the meeting in spite of the snowy day.

Approval of Minutes of the November 10, 2009 IAC Meeting

Chairman Roxe asked for comments on the Minutes of the November 10, 2009 IAC meeting. **There being no comments, a motion was made by Carol Thomas, seconded by William Murray, that the Minutes of the November 10, 2009 IAC meeting be accepted as drafted. The motion was passed unanimously with the exception of Thomas Fiore who abstained due to his absence from the meeting.**

Comments by the Treasurer

Treasurer Denise Nappier began her comments by extending her warmest holiday greetings to all present. She commented on the status of the Connecticut Retirement Plans and Trust Funds ("CRPTF"), noting improved relative performance and her expectation for continued improvement. For the one-year period ending October 31, 2009, Treasurer Nappier said that CRPTF was up by more than 13%, outdistancing the double digit negative performance for the same period last year. She commented on similar results over the seven-year horizon, with an annualized return of 643 basis points ("bps"), much improved over the October, 2008 performance of 355 bps.

Turning to today's agenda, Treasurer Nappier stated that an update on the Alternative Investment Fund ("AIF") would be provided and that discussion of the due diligence process for the AIF, which began at the November 10, 2009 meeting, would continue. She noted that the ongoing overviews and discussions regarding the AIF were beneficial and that the AIF was an important strategic component for achieving the CRPTF's overall portfolio objectives. Treasurer Nappier stated that in preparation for the implementation phase of the AIF, a recommendation to conduct an expedited search for specialized legal services for the AIF would be presented for consideration at today's meeting.

Also on today's agenda, Treasurer Nappier stated that the Fiscal Year 2010 cash flow report projections for both the Teachers' Retirement Fund ("TERF") and State Employees' Retirement Fund ("SERF") would be provided. She added that the CRPTF's cash needs were of utmost importance and deserved detailed discussions. Treasurer Nappier emphasized that the cash requirements for the TERF and SERF would not be satisfied by interest and dividend payments from the portfolio noting that the balance of cash flow required would be sourced from sales of core investments through routine rebalancing. Treasurer Nappier stated that net benefit outflows were continuing to increase, and dislocations in the equity and credit markets have reduced dividend and interest income and expected realized capital gains. She added that the full impact of the Early Retirement Incentive Program for State employees was still not known. Through the OTT's liquidity monitoring efforts and by strategic design, Treasurer Nappier stated that the OTT had effectively planned for these events.

Chief Investment Officer's Update on the Market, CRPTF Final Performance for the Month Ended October 31, 2009, Combined Investment Funds Review, Watch List Update and Connecticut Horizon Fund Review for the Quarter Ended September 30, 2009

M. Timothy Corbett, Chief Investment Officer ("CIO"), provided an update on the capital market environment and its impact on the performance of the CRPTF. He began by commenting on the economic news since the last IAC meeting. Mr. Corbett stated that there were only 11,000 job losses in November 2009, much lower than the estimate of 110,000 losses. He said that the Federal Reserve's *Beige Book* reported that conditions were "mixed to moderately improving" across most sectors of the economy except for commercial real estate. Mr. Corbett then spoke about the CRPTF's longer-term investment themes and strategy over the next several years.

Mr. Corbett reported on the performance for the CRPTF for the month ended October 31, 2009. He stated that the CRPTF returned negative 1% in October, but still was up by almost 15% for the calendar year-to-date. He reported that five of the eight public market funds outperformed their benchmarks and two underperformed for the trailing three months, showing improvement over the prior three-month period. Mr. Corbett stated that relative to peers, performance was average during the third quarter of 2009, was in the 36 percentile over the trailing year and was in the top third for the trailing five and ten year periods within that universe. He said that speaks to the quality of the investment process and the portfolio built over time.

Joseph Barcic, Principal, and Rashid Hassan, Associate, Mercer Investment Consulting, Inc., ("Mercer") provided additional comments on the overall investment results for the CIF for the quarter ended September 30, 2009. Mr. Barcic began by providing a review of the Mutual Equity Fund's ("MEF") performance and stated that the overall performance of the MEF had been similar to the benchmark and slightly better than its peers. He provided a brief analysis of the bull and bear markets which occurred between 1996 and 2009. He then commented on the two market cycles, which included the periods of April 1996 to September 2002 and September 2002 to February 2009, and he noted that the MEF performed quite well during both periods.

Mr. Hassan stated that high quality companies tended to do poorly in the beginning of a bull market but usually outperformed over the full cycle. He said that Mercer was focusing on identifying managers that could perform well during a rapidly rising market for the Small to Mid Cap ("SMID") equity manager search that was underway for the CRPTF. Discussion ensued about indexing versus active management styles.

Discussion continued about the SMID portion of the MEF. Mr. Barcic elaborated on the SMID strategy and its potential to add value by utilizing managers with different style biases. In response to Chairman Roxe's question regarding what percentage of the portfolio was indexed, Mr. Barcic stated that about 65% of the large cap MEF portfolio was indexed as of September, 2009. Chairman Roxe stated that it was strategically important to discuss the use of indexing for large cap public markets and if the results should be reviewed against benchmarks or against longer-term objectives. David Roth stated that it was important to understand the investment philosophy of the OTT. Deputy Treasurer Rifkin stated that the framework of the existing asset allocation plan, the strategy and investment philosophy were already captured in the Investment Policy Statement.

Mr. Barcic then reported on the TERF's attribution analysis for the quarter ended September 30, 2009, which included more that half of the assets in the CRPTF and has exposure to all of the underlying funds. He said that the TERF had a return of 11.6% versus the target return of 13.2%, and he noted that manager selections have been the largest detractor from performance during the quarter and one-year period. Regarding the 2008 calendar year, Mr. Barcic reported that while the TERF's return was negative, it still outperformed the benchmark by 5.9%, with manager selection the largest contributor to this outperformance.

Mr. Corbett then provided an update on the CRPTF Watch List as of September 30, 2009. He reported that TCW's Watch List status was being addressed as part of the SMID search. Mr. Corbett said that TCW has been on watch since November 2007 for performance issues. Mr. Corbett said that Goodwin Capital Advisers was still on watch due to organizational change, but that its performance had solidly rebounded providing the best performance in the Core Fixed Income Fund for 2009.

Mr. Corbett provided a report on the Connecticut Horizon Fund ("CHF"). He noted that reports were provided by Rogerscasey for the public market portion of the CHF, and by Franklin Park Associates LLC ("Franklin Park") for the private market portion of the CHF. Mr. Corbett reported a 14.1% return for the four public market fund-of-funds for the quarter ended September 30, 2009, underperforming its benchmark by 42 bps; but he noted that they outperformed for the last year and since inception. He then commented on the individual manager's performances. Regarding, the private market portion of the CHF, Mr. Corbett reported that this program was very young in years and is performing on plan.

<u>Update on the Cash Flow Report for the Teachers' Retirement Fund and State Employees' Retirement Fund</u>

Lee Ann Palladino, Deputy CIO, provided the results of the Cash Flow Report for the fiscal year ended June 30, 2009 and projections for Fiscal Year 2010 for the TERF and State Employees' Retirement Fund ("SERF"). Ms. Palladino began her remarks by first providing information about historic cash flow trends for SERF and TERF, and noted that the cash requirements for those two funds have exceeded the cash generated by their investments beginning with Fiscal Year 2009.

Ms. Palladino reported that the cash requirements for the SERF would increase by 84% in Fiscal Year 2010, and for TERF the increase would be 58%, and noted that current contributions for all of the plans are less than pension benefit payments. She further described the partial pension contribution suspension agreements for Fiscal Years 2009 and 2010. Ms. Palladino said that the net benefit outflow in 1999 was $436 million, in 2009 was $954 million, and it was estimated to be $1.08 billion in 2010. Treasurer Nappier pointed out that historically the State did not always fund 100% of the actuarial required contributions. She stated that because of the expected growing trend of pension benefit payments exceeding contributions, the LF was originally established to meet disbursement requirements without dipping into the core portfolio. Discussion ensued about the unfunded liability, the Pension Obligation Bond ("POB"), projections for the next few years and future legislation that could impact the pension fund.

Ms. Palladino commented on the draw on cash that occurred due to the CRPTF's investment in the Real Estate and Private Investment Funds ("REF" and "PIF"). She provided a brief history about the REF and PIF and discussed capital calls and distributions. She then discussed the vintage year strategy, capital gains and losses, dividend and interest receipts for the PIF and REF and their impact on cash flow. Ms. Palladino stated that ultimately the expected rise in interest rates and the positive upward trend of the stock markets could have a positive impact on cash flow. In closing, she said that cash requirements for the SERF and TERF would continue to increase and she commented on the many variables that could affect cash flows. Discussion ensued about the actuarial assumptions, the benefit of the POB, the aging employment force and state pension plan peers.

Update on the Alternative Investment Fund and Discussion of Due Diligence Process

Ms. Palladino led a discussion about the status of the AIF and the due diligence process for selecting AIF managers. Ms. Palladino began by providing a brief recap of the discussion that began at the November 10, 2009 IAC Meeting, and she highlighted the topics that would be discussed at today's meeting, which would focus on the absolute return fund-of-funds due diligence process.

Jaeson Dubrovay, Senior Consultant of New England Pension Consultants ("NEPC"), and Cynthia Steer, Managing Director of Rogerscasey, provided presentations on their firm's respective due diligence processes. Mr. Dubrovay began by commenting about NEPC's alternative research team and highlighted their experience. He stated that NEPC employed 37 dedicated research professionals that focused on innovative strategies. Mr. Dubrovay discussed NEPC's hedge fund resources, alternatives experience and hedge fund strategy exposures. He explained NEPC's process for identifying and selecting managers. Mr. Dubrovay stated that NEPC used a three-tier due diligence approach by focusing on the business model, strategy review and operational due diligence using validation procedures designed in-house and performed onsite. He stated that different organizations accept different levels of risk; therefore, each organization must be evaluated on an individual basis. In response to questions posed by Chairman Roxe, Mr. Dubrovay explained NEPC's initial and ongoing operational due diligence process, and stated that this was independent from the investment research team. He noted that a fund must be approved by both the investment and operational teams to be placed on the recommended list. Mr. Dubrovay then responded to several questions posed by IAC members with respect to reporting, monitoring, and NEPC's risk management skills and experience with writing best practice provisions in side-letter contracts. He discussed the operational due diligence items that are researched and the documents that are requested. Finally, Mr. Dubrovay commented on NEPC's manager database, the change in the landscape for the hedge fund industry and the lessons learned from 2008. Discussion ensued about assessing operational risk management, NEPC's risk management skills, whether the due diligence process was different for hedge funds from that of private equity, auditor valuations and the need for reliable top auditing firms.

Ms. Steer commented on Rogerscasey's selection process for choosing best-in-class investment managers. She highlighted the benefits of investing in hedge fund-of-funds versus direct investing in hedge funds, which included better diversification, due diligence, risk management and access. Ms. Steer explained Rogerscasey's manager research and ranking system, and she said that it provided a disciplined approach to manager due diligence and evaluation. She then highlighted the difference in the due diligence process of hedge funds versus hedge fund-of-funds. Ms. Steer said that Rogerscasey provides on-going, in-depth, on-site due diligence, and she highlighted the changes in the hedge fund environment that had occurred post 2008. Discussion ensued about the different requirements of investing directly in hedge funds versus hedge fund-of-funds.

In closing, Ms. Palladino gave a brief overview of the risk committee and its areas of focus. She stated that the approach for risk management for alternatives is different from risk management for traditional assets. Ms. Palladino then provided examples of how alternative versus traditional risks were reviewed, and discussed the distribution of returns and the various measures of risk. Finally, she commented on how Rogerscasey and NEPC would provide ongoing program support and monitoring.

Consideration for the Search Process for Legal Counsel for Alternative Investment Fund

Catherine LaMarr, General Counsel, provided a project plan, timeline and evaluation/selection criteria for Legal Counsel for the AIF. Ms. LaMarr said that the OTT needed to have legal expertise with capabilities to handle the new asset categories that had underlying investment vehicles including commodities and infrastructure. She said that a pool of counsel was preferable in case there were conflicts of interest and for competition purposes, and she cited recent Supreme Court legislation that pointed to a need to step up due diligence. In response to Chairman Roxe's question, Ms. LaMarr stated that these law firms would not be retained, just contracted, meaning that they would only be paid for actual services provided.

Chairman Roxe then asked for a motion to endorse the Search Process for Legal Counsel for the AIF. **Ms. Thomas entered a motion to move forward with this search. David Himmelreich seconded the motion. The motion was passed unanimously.**

Real Estate Fund Review as of June 30, 2009

Mr. Corbett introduced David Johnson, Principal Investment Officer, and Scott Booth, Principal of The Townsend Group ("Townsend"), who would report on the REF for the quarter and fiscal year ended June 30, 2009. He said that Mr. Johnson would focus on three areas during his report on the REF including: 1) the appropriate real estate index; 2) an attribution analysis; and, 3) a description of the current structure and performance of the REF.

Mr. Johnson began by stating that Moody's Commercial Property Index was down 42.9% peak-to-trough. He commented that this was the worst correction since the *"Great Depression"*, even greater than the 1991 adjustment. Compounding the current situation versus 1991, Mr. Johnson stated that commercial mortgage-backed securities financing had gone from $220 billion per year to less than $1 billion; bank financing for new loans was down 86%, life insurance company financings were down 71%; and $1.5 trillion in commercial mortgages were coming due within the next four years. Mr. Johnson stated that despite these catastrophic events facing the real estate industry, CRPTF was well-positioned to weather the storm.

Mr. Johnson then presented the REF's quarterly report for the period ended June 30, 2009. He commented on the REF's reporting and benchmark, the NPI, an unleveraged index. Mr. Johnson stated that Townsend had teamed up with the National Council of Real Estate Investment Fiduciaries ("NCREIF") to produce leveraged returns that more accurately reflected CRPTF's performance vis-à-vis the competition.

Mr. Johnson provided an attribution analysis for the REF portfolio's performance. He stated that the largest contributor to underperformance were the investments made during the vintage years of 1997 and 1998 under the prior administration, which did not come close to the median return of 11.3%, but the REF actually posted a return of 1.0 % or 1030 bps below the median. Mr. Johnson reported that the REF investments made between 2004 and 2007 were all outperforming the median expected return.

Mr. Johnson then discussed why investments made between 2004 and 2007 were actually doing better than the median. He stated that the CRPTF made: a $425 million commitment to low risk core real estate, which outperforms during a down market; a $310 million commitment to value add rather than highly-leveraged opportunistic funds; and a disciplined investment pace on the opportunistic funds investments.

In response to Stanley Morten's question regarding returns for Real Estate Investment Trusts ("REITs") or Exchange-Traded Funds ("ETFs") versus NCREIF, Mr. Booth stated that REITs were highly correlated to stock market performance, neutralizing their value in a diversified portfolio. On the other hand, he said that private real estate was not highly correlated to the stock market; thereby providing substantial portfolio benefit. Mr. Booth opined that the crisis mode of the past two years, where institutional investors focused on asset management and damage control, had ended for many real estate investors. He added that, historically, the periods following severe downturns had produced some outsized returns. Mr. Booth then commented on the allocation and funding status of the REF. He said that unfunded commitments would be used for new investments with expected above-average performance. In closing, Mr. Booth commented on the portfolio performance and noted some positive results were expected for 2009's third quarter. Chairman Roxe noted that if the older investments were taken away, the portfolio was actually doing better than the generation year comparables and it appeared that it would soon be a good time to invest in real estate.

Private Investment Fund Review as of June 30, 2009

Ms. Palladino reported on the PIF for the quarter and fiscal year ended June 30, 2009, and Bradley Atkins, Chief Executive Officer of Franklin Park Associates, LLC, was available for questions. Ms. Palladino began her presentation by providing an update on the private equity market and commenting on global fund-raising activity. She stated that year-over-year, 2008 versus 2009, buyout activity was down 70% and venture capital fund-raising activity was down 64%, with the expectation that activity would continue to be low. Regarding mergers and acquisitions, she stated that activity was down to levels that hadn't been seen since 2003 for the entire market place. For current investment activity, Ms. Palladino stated that both buyout and venture capital firms fell to their lowest levels in ten years; and as a result, capital calls have been low. She did report good news for pricing levels and leverage noting that they both had fallen significantly creating more attractive and financially sound transactions. Regarding the recent trend in distributions, Ms. Palladino stated that the private investment market has been weak and noted that mergers and acquisitions for buyout and ventures fell 64% during the third quarter of 2009 versus 2008, but she added that public market investing activity was improving for the 2009 calendar year, which means that the PIF would require $500 million more than it would generate.

Ms. Palladino reported that $6.3 billion has been committed to 75 funds within the PIF, and $1.6 billion has been invested with about $1.6 billion in unfunded commitments. She reported that the PIF outperformed its dollar-weighted U.S. equity public market equivalent benchmark across all the investment horizons. From a vintage year perspective, she stated that from 1999 and earlier, primary funds and fund-of-funds did not perform as well as their benchmark. However, post 1999, Ms. Palladino reported that they were close to top-quartile fund performance, with an outperformance of top quartile for the years 2002, 2004, 2007 and 2008. Ms. Thomas commented about the practices during the prior administration when investments were made in the 1997, 1998 and 1999 vintage year funds.

Ms. Palladino reported that while the PIF's valuation was down 18.3% and 2.1% for the quarters ended December 31, 2008 and March 31, 2009 respectively, there was a positive change of 3.3% for the quarter ended June 30, 2009, and continued improvement could be expected. Ms. Palladino stated that both cash flows and distributions had come down significantly but added that capital calls would still outpace distributions during the 2010 calendar year.

Short-Term Investment Fund Review as of September 30, 2009

Lawrence Wilson, Assistant Treasurer-Cash Management, reported on the performance of the Short-Term Investment Fund ("STIF") for the quarter ended September 30, 2009. He stated that the STIF earned an average annualized yield of .45%, which was 29 bps above its benchmark, resulting in an additional $5.2 million above the benchmark for the investors. Mr. Wilson commented that the STIF's cautious investment practices continued; and as a result, it currently held 87% of fund assets in investments that are available on a same-day or next-day basis with an average-weighted maturity of ten days. He said that 65% of the portfolio had been invested in securities that are insured, guaranteed or issued by the federal government or federal agencies in money funds or in repurchase agreements backed by such securities. Mr. Wilson said that STIF's reserves currently totaled $36 million or roughly .8% of fund assets. In response to Chairman Roxe, Mr. Wilson spoke about the types of accounts the portfolio was currently invested in. He noted that over the past couple of years, the STIF had moved away from asset-backed commercial paper into a much more conservative class of investments.

Other Business

Mr. Corbett provided a report on the IAC expenses for the quarter ended September 30, 2009. He stated that the $35,800 budget for Fiscal Year 2010 has been forecasted to be under budget by $7,013, mainly due to less spending on education. Mr. Corbett stated that the total expense was $16,682 for Fiscal Year 2009.

Chairman Roxe then invited IAC members to submit agenda items for the January 13, 2010 IAC meeting. Mr. Corbett stated that fund-of-funds for the alternative managers may be on the agenda for next month. Mr. Roth added that it might be helpful to have an educational session regarding new terminology and calculations that were being used in reporting.

Comments by the Chairman

Chairman Roxe complimented Treasurer Nappier and her staff on the quality of the presentations at today's meeting.

There being no further business, the meeting was adjourned at 3:30 p.m.

An audio tape of this meeting was recorded.

Respectfully submitted,

Denise L. Nappier

DENISE L. NAPPIER
SECRETARY

Reviewed by

JRoxe

JOSEPH D. ROXE
CHAIRMAN