

**EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
ANNUITY AND PENSION BOARD**

Minutes of the Investment Committee Meeting
held October 7, 2010

The meeting was called to order at 9:05 a.m.

Committee Members Present: John Barmore
 Konrad Ellenberger
 Larry Holland
 Gust Petropoulos

Committee Members Not Present: William C. Carey (excused)
 W. Martin Morics (excused)
 Michael J. Murphy (excused)
 Ron Walter (excused)

Retirement Staff Present: Bernard J. Allen, Executive Director
 Martin Matson, Deputy Director
 Tom Rick, Chief Investment Officer
 David Silber, Pension Investment Analyst
 Bruce Thomas, Pension Investment Analyst
 Suzanne Fortier, Board Stenographer

Others Present: Doug Kryscio and Patricia Hafner, Mercer Investment Consulting; Beth Cleary, City Attorney's Office; Rob Kochis and Roberta Waxman-Lenz, The Townsend Group; John Phillips and Vicki Fuller, Alliance Bernstein; and Chris Garrett, Brandes Investment Partners.

Due to the lack of a quorum, the meeting convened as a sub-committee.

Mr. Barmore indicated that Mr. Kryscio wanted to address the Committee regarding an announcement. Mr. Kryscio informed the Committee that about 30 minutes ago his boss talked to Mr. Allen, Mr. Rick and Mr. Petropoulos, informing them that Mercer's parent company, Marsh McLennan, and Mercer had decided that they are going to exit the public fund defined benefit retainer work. He apologized for springing this on the Committee this morning, but he and Ms. Hafner just found out. Mr. Kryscio stated that Mercer has committed to stay on ERS' account until such time as ERS finds a suitable replacement for Mercer. He indicated that Mercer just signed a three month extension with ERS, and they would be happy to continue beyond that extension as long as ERS needs. Mr. Barmore expressed disappointment in Mercer's decision and noted that Mr. Kryscio and staff have given ERS an outstanding level of service. Discussion ensued.

Acceptance of Alliance Bernstein Due Diligence Report. As a matter of information, Committee members received a memorandum from Mr. Silber, dated October 1, 2010. Mr. Silber reported that at the end of August, he, and Messrs. Rick, Barmore, Allen and

Kryscio conducted a due diligence visit to New York to Alliance Bernstein's office. He said they came away from the visit with a few concerns, which are highlighted in the report in the packet. Mr. Silber said the main concern was with employee turnover at the senior levels of the US large cap strategy to which ERS invests. He briefly talked about some of the areas of turnover; and Bernstein's performance. Lengthy discussion ensued.

Alliance Bernstein Presentation. As a matter of information, Committee members received a presentation book. Mr. Rick handed out an updated performance chart. Mr. Silber briefly talked about Alliance Bernstein's performance. Ms. Fuller talked about the firm. Mr. Phillips talked about the three bubbles that have happened in the last ten years. He said the behavior Bernstein captures is that of investors that over-react to short-term events, and also companies behavior. Mr. Phillips said their approach to capturing the behaviors is to make long-term forecasts and to make use of fundamental as well as quantitative research. He said the portfolio is subject to these on again, off again, risk on, risk off months that have been characterizing the environment. Mr. Phillip said it especially had an impact over the last six months as the tastes for risk are extraordinarily volatile, and that detracts broadly from a return. He said Bernstein is staying the course. The turnover in the portfolio is somewhat higher; volatility in the market is quite a lot higher, and that changes the riskiness of individual stocks as well as their valuations. Mr. Phillips said there has been a high degree of correlation among stocks even though there are large distinctions in their actual reported results. He said this is physically challenging for active management, but this too is abnormal and should pass. That is the basic message. Mr. Phillips said we are in the midst of a value cycle, which was interrupted in the second quarter and again in August, but the valuation is so attractive for the portfolio versus the market and equities themselves are so attractive versus fixed income, that he thinks it is just a matter of time.

Mr. Phillips talked about the basic strategy, which is harnessing the power of cash; the depressed valuations; the strength of the balance sheets despite the valuations. He also talked about the performance summary from March 1, 2009 through March 31, 2010 stating Milwaukee stayed the course and was up in that period almost 67 percentage points. Performance in 2009 was 27.7 percent versus the benchmark return of 19.7 percent. Mr. Phillips did state that the experience of 2007-2008 has had a very negative impact on the one, three and five year numbers. He talked about how performance reflects heightened risk aversion; the hostile environment for value investing; price to book spreads; cash and value; and buys and sells. Discussion ensued.

Mr. Barmore called for a break at 10:10 a.m. The sub-committee reconvened at 10:17 a.m.

Mr. Barmore stated that he would take the agenda out of order and take up item V.

Townsend Group Presentation. As a matter of information, Committee members received a presentation book, Real Estate Program Update, dated October 7, 2010. Townsend handed out a presentation book on Timberland Investing, dated October 7, 2010. Mr. Rick handed out an updated performance chart. Mr. Rick briefly talked about

ERS' real estate portfolio. Mr. Kochis stated they are quite excited as they can clearly see that the markets have finally bottomed and turned. He said Townsend has become very active in 2010 in terms of trying to find some good tactical ways to take advantage of the dislocation in the market and also to build ERS' program back up. Mr. Kochis said ERS is at about \$212 million invested in real estate today, which is about 5.5 percent of the 7 percent target. He noted that part of that is driven by the market and some is by design because Townsend basically took off a year in terms of making any new investments on ERS' behalf when the markets were correcting.

Mr. Kochis talked about the real estate market environment stating Townsend feels confident that in 2010 real estate could be poised to have a decent year with a return of approximately 10 percent. He talked in length about ERS' real estate portfolio indicating ERS is back in positive territory with the performance over the last couple of quarters, but you had some pretty significant losses that are embedded in your returns over the last three and five years. Mr. Kochis said we have to let the market play out to see what the end results are going to be as we are still at the bottom of the market cycle. He said during this correction, ERS' portfolio generated about \$32 million of cash back to the plan so the portfolio is generating good positive cash flow that can be used to pay benefits and fund other investments. Mr. Kochis and Ms. Waxman- Lenz talked to the Committee on ERS' current holdings and new investments going forward. Discussion ensued throughout the presentation.

Mr. Kochis proceeded to discuss the Timberland Investing. Discussion ensued throughout the presentation.

Mr. Barmore called for a break at 11:36 a.m. The sub-committee reconvened at 11:45 a.m.

(Mr. Holland left the meeting at 11:36 a.m.)

Brandes Investment Partners Presentation. As a matter of information, Committee members received a copy of the Brandes presentation book. Mr. Rick handed out an updated performance chart. Mr. Silber briefly talked about Brandes' performance. Mr. Garrett provided some background information on Brandes. He stated that Brandes underperformed by a fairly significant margin in 2009 and he talked about the issues causing the underperformance. Mr. Garrett reported that through August Brandes was slightly ahead of the benchmark; and the estimated numbers through the end of September show we are behind by 50 to 70 basis points. He also talked about long-term potential; industry exposure and country exposure. Lengthy discussion ensued.

Acceptance of Turner Investment Partners Due Diligence Report. As a matter of information, Committee members received a copy of a memorandum from Mr. Thomas, dated October 1, 2010. Mr. Thomas stated he, Messrs. Barmore, Rick, Allen and Kryscio visited Turner on August 23, 2010. He noted they met with Mark Turner, people from their Investment Analysts groups, and their head trader. Mr. Thomas stated Turner has been struggling over the last couple of years, and are underperforming their benchmark

and rank below median in their peer universe. He said they came away from the meeting with some concerns, one being Turner's inability to give ERS the outlook of the strategy going forward. Mr. Thomas said ERS staff is going to analyze Turner more closely, along with the other U.S. large cap managers for potential changes. Discussion ensued.

Approval of Changes to ERS Transition Panel. As a matter of information, Committee members received a copy of the Transition Manager Capabilities and Control Benchmark, dated October 1, 2010, submitted by Mercer. Mr. Rick stated that ERS staff had talked to Mercer about repopulating our transition panel back in 2008. He reported that three of the five members left transition services. Mr. Rick stated ERS asked Mercer to repopulate the list with two to three more transition managers that ERS can use in the event we want to move assets from one manager to another. Before you is a summary of what Mercer looked at, and makes the recommendation of adding J. P. Morgan, Northern Trust, and State Street to the existing transition managers currently on the panel. Mr. Rick stated both Mercer and staff recommend approval.

Commodities Education. As a matter of information, Committee members received a copy of the presentation book from Mercer "The Case for Commodities". Mr. Barmore said there was a discussion of deferring this to the full Board for the educational component and consideration of a possible manager search. Mr. Kryscio briefly talked about the next steps to be taken with regard to ERS moving forward on commodities. Discussion ensued.

There being no further business, Mr. Barmore adjourned the meeting at 12:22 p.m.

Bernard J. Allen
Secretary and Executive Director

(**NOTE:** All proceedings of the Annuity and Pension Board Meetings and related Committee Meetings are recorded. All recordings and material mentioned herein are on file in the office of the Employees' Retirement System, 789 N. Water Street, Suite 300.)