

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

Minutes of the Investment Committee Meeting
held December 8, 2010

The meeting was called to order at 9:08 a.m.

Committee Members Present: John Barmore
 Konrad Ellenberger
 W. Martin Morics
 Michael J. Murphy
 Gust Petropoulos

Committee Members Not Present: William C. Carey
 Larry Holland
 Ron Walter

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
 Brian Brophy, College Intern
 Suzanne Fortier, Board Stenographer

Others Present: Beth Cleary, City Attorney's Office; Doug Kryscio and Patty Hafner, Mercer Investment Consulting; Pamela Newton; Christopher Doell and Daniel Hynes, Northern Trust; Mark Egan and Thomas Fink, Reams Asset Management.

Mr. Kryscio reported to the Board that he would be leaving Mercer to join William Blair in a client service role. He stated that technically his region would be the east coast, but he has worked it out with Blair to continue his relationship with ERS. Mr. Kryscio noted that Ms. Hafner will be staying with Mercer and she will continue working with ERS until you have a new Investment Consulting firm in place.

3rd Quarter Performance Presentation. As a matter of information, Committee members received copies of Mercer's Board Report Period Ending September 30, 2010, and ERS' 3rd Quarter Performance Report, dated December 8, 2010. Mr. Kryscio briefly talked about the economy. Mr. Rick talked about: ERS' asset allocation; stating the Fund's value of assets as of September 30, 2010 was almost \$4.1 billion; year-to-date market value change; Fund had a 9.9 percent return at the end of the quarter ending September 30, 2010; total Fund 5-year performance and statistics; and the total Fund vs. universe.

Mr. Silber reported the domestic equity 3rd quarter performance had a return of 11.3 percent, which trailed its benchmark by 20 basis points, mainly due to underperformance

by four of the six active managers. He noted the composite is still outperforming year-to-date, but underperforming over the three and five year time periods. Mr. Silber talked about the domestic equity 5-year performance and statistics; domestic equity vs. universe; relative performance – domestic equity managers. He reported that the international equity composite had very strong absolute returns for the third quarter, with a 15.5 percent return during the quarter; however, it still underperformed its benchmark by 1 percent. Mr. Silber talked about the international equity 5-year performance and statistics; international equity vs. universe; and relative performance – international equity managers.

Mr. Thomas said that in the global markets – domestic, international and the emerging markets all had strong performance in the third quarter, and both ERS' managers outperformed. GMO's outperformance comes from their securities selection in Japan, as well as their holdings in healthcare, the financial sector and information technology. He stated that T. Rowe's outperformance can be attributed to their holdings in US and China, as well as stock selections in consumer discretionary and information technology. Mr. Thomas stated within the fixed income market there was a parallel shift downwards in the yield curve resulting in bond prices rising. High yield and investment grade credit managed to outperform treasuries, mainly due to the improving fundamentals of corporate balance sheets. He reported the fixed income composite had a 4.4 percent return, outperforming its benchmark by about 190 basis points. Mr. Thomas talked about the fixed income 5-year performance and statistics; fixed income vs. universe; and relative performance – fixed income managers.

Mr. Thomas reported that the estimated market value as of November 30, 2010 was \$4.1 billion; September year-to-date shows 150 basis points of outperformance; October had 40 basis points of outperformance; and November's estimate is 30 basis points of outperformance; the estimate November year-to-date is 230 basis points of outperformance; the estimate for the month of December shows the Fund up 3.2 percent; and year-to-date the Fund is estimated to be up 12.4 percent. Mr. Rick stated the Fund's value is about \$4.25 billion. It was moved by Mr. Barmore, seconded by Mr. Morics, and unanimously carried, to receive and accept the report.

Approval of Loomis Sayles Guideline Change Request. As a matter of information, Committee members received copies of a memo from Mercer, dated November 30, 2010 and a letter from Loomis Sayles outlining the guideline change, dated October 29, 2010. Mr. Rick stated that when Mercer and ERS staff went out to visit Wellington on the due diligence, they stopped in to visit with Loomis Sayles and met with Mr. Fuss. Based on that meeting, Loomis would like to request increasing their exposure to non-dollar debt. He noted that Loomis views this as a way to gain greater access to the commodity rich countries like Australia. Mr. Rick stated Loomis can use the non-dollar debt as an inflation hedge. He noted that Mr. Fuss mentioned that the guidelines that Loomis is requesting to be approved are really a mirror image of his flagship Loomis Bond Fund. Mr. Rick indicated that staff and Mercer are recommending approval. It was moved by Mr. Petropoulos, seconded by Mr. Morics, and unanimously carried, to approve the Loomis Sayles Guideline change.

Approval of Wellington Management Contract and Due Diligence Report. As a matter of information, Committee members received copies of the Investment Management Agreement and a memorandum from Mr. Rick, dated December 3, 2010. Mr. Rick stated the contract is modeled after the approved boilerplate contract, with some relatively minor modifications. He said the fee schedule was negotiated down to 25 basis points on a \$200 million mandate, and anything over \$200 million would be a 20 basis point fee. Mr. Rick talked about the due diligence visit. Discussion ensued with respect to Wellington being among several firms that have been subpoenaed in connection with an ongoing federal investigation into potential insider trading. Mr. Kryscio stated that Ms. Hafner has talked to Mercer's research group, and there is nothing that would alarm Mercer to say that ERS should not fund Wellington. He said that he thinks at the end of the day Wellington will resolve this and be okay. After discussion, it was moved by Mr. Petropoulos, seconded by Mr. Morics, and unanimously carried, to approve the Wellington Contract and accept the due diligence report, based on the recommendations of Mercer and staff.

Approval of Northern Trust Due Diligence Report. As a matter of information, Committee members received a copy of a memorandum from Mr. Thomas, dated November 30, 2010. Mr. Thomas talked about his visit to Northern Trust. He noted that they talked about the S&P 500 index fund and, more specifically, the Securities Lending where Northern has made some changes to create a more conservative lending pool within the index. Mr. Thomas stated we can see the results of that where the tracking error has normalized to within the ranges ERS is use to seeing. It was moved by Mr. Morics, seconded by Mr. Barmore, and unanimously carried, to accept the due diligence report and place on file.

Approval of Statement of Investment and Private Equity Policy. As a matter of information, Committee members received copies of the Statement of Investment Policy (one copy was relined to show the changes) and a copy of the Private Equity Statement of Investment Policy, dated December 2010. Mr. Allen handed out a letter from the City Attorney's Office, dated December 6, 2010. Mr. Rick stated Mercer, staff and the City Attorney's Office all worked on updating the Statement of Investment Policy. He indicated they have also drafted a separate Private Equity Statement of Investment Policy, which is referenced in the Statement of Investment Policy. Mr. Rick briefly talked about the changes to the document. After discussion, it was moved by Mr. Morics, seconded by Mr. Petropoulos, and unanimously carried, to approve the Statement of Investment Policy and the Private Equity Statement of Investment Policy.

(The agenda was taken out of order at this time.)

Domestic Large Cap Equity Analysis. As a matter of information, Committee members received a copy of Mercer's Report, "Active vs. Passive Management Large Cap Domestic Equity", dated December 8, 2010. Mr. Kryscio talked about the background regarding active vs. passive management and steps the Board has already taken in this area; objective of the discussion – key takeaways; Mercer's analysis and

observations – U.S. Large Cap Equity; and options to consider. Lengthy discussion ensued throughout the presentation.

Fixed Income Portfolio Discussion. Mr. Kryscio briefly talked about ERS' current fixed income managers and portfolio. Brief discussion ensued.

Mr. Murphy called for a break at 10:37 a.m. The Committee reconvened at 10:50 a.m.

Northern Trust Custody, Security Lending and Investment Management Presentation. As a matter of information, Committee members received a presentation book, dated December 8, 2010. Mr. Rick handed out an updated performance chart. Mr. Thomas briefly talked about Northern Trust's S&P 500 Index Fund. Ms. Newton briefly addressed the Committee on their last Client Conference; upgrades to their Passport system; and introduced Mr. Doell and Mr. Hynes.

Mr. Doell talked in length about the Securities Lending process. He also talked about the historical net securities lending earnings by year for ERS; and the core market to book history as of September 30, 2010. Mr. Hynes talked about the S&P 500 Index Fund performance as of October 31, 2010 stating year-to-date ERS' portfolio is up about 1 basis point over the benchmark. He also talked about trends in global investing – index management demand and expanding the investable universe.

Discussion ensued throughout the presentation.

(During the above presentation, Mr. Petropoulos left the meeting at 11:18 a.m.)

(Ms. Cleary left the meeting at 11:55 a.m.)

Reams Asset Management Presentation. As a matter of information, Committee members received a presentation book, dated December 8, 2010. Mr. Rick handed out an updated performance chart. Mr. Silber updated the Committee on Reams' performance. Mr. Fink briefly talked about Reams becoming a division of Scout Investment Advisors and provided some background information on that company. He and Mr. Egan provided an overview of Reams. Mr. Fink talked about Reams' objectives and guidelines and possible changes that would be appropriate given the overall market environment. He noted they are at the bottom end of the duration band, plus or minus 25 percent of the index; portfolios that would give Reams more flexibility would be plus or minus 2 years around the duration band, that would give Reams more flexibility and ability to be defensive within the portfolio. Mr. Fink stated another comment is just the use of derivatives, credit default swaps, and the absolute return fund. Those types of strategies allow broader diversification within the portfolio, and also allow a better duration or interest rate risk management within portfolio. It was moved by Mr. Morics, seconded by Mr. Barmore, and unanimously carried, that Reams communicate the recommendations in writing for consideration. Mr. Fink provided a summary of ERS' portfolio and a review of the market. He talked about performance stating that through

October 31, 2010 the portfolio, on a gross basis, is up 9.73 percent; on a net basis the portfolio is up 9.56 percent, year-to-date; and the index had a return of 8.33 percent.

Mr. Egan talked in length about the sector spreads; and Reams' economic review. He also talked about Reams' fixed income outlook and strategy summaries. Mr. Egan talked briefly about the portfolio. Discussion ensued throughout the presentation.

There being no further business, Mr. Murphy adjourned the meeting at 12:45 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.)