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

Minutes of the Investment Committee Meeting
held February 14, 2007

The meeting was called to order at 9:10 a.m.

Committee Members Present:	John Barmore W. Martin Morics
Committee Members Not Present:	William C. Carey (arrived later in meeting) Larry Holland Michael J. Murphy Sebastian Raclaw (arrived later in meeting) Ron Walter
Retirement Staff Present:	Michael C. Dolsen, Secretary & Executive Director Martin Matson, Deputy Director Tom Rick, Chief Investment Officer David Silber, Pension Investment Analyst Kathleen Conway, Board Stenographer

Others Present: Brad Blalock, Mercer Investment Consulting; Elizabeth Conradson Cleary, City Attorney's Office, and George Greig and Julie Stevens, William Blair & Company.

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

Mercer Q4 2006 Performance Presentation. As a matter of information, Committee members received a copy of a Fourth Quarter 2006 – Board Report, submitted by Mercer Investment Consulting, and a copy of ERS' 4th Quarter 2006 Performance Report, dated February 14, 2007. Mr. Blalock talked about the market environment stating the fourth quarter was a very good quarter, and for the year the Fund did very well.

(Mr. Raclaw arrived at 9:11 a.m.)

Mr. Blalock said the GDP growth was strong at 3.5%; payroll reports were showing strength, and unemployment was down to 4.5%. He said the consumer confidence was improving, but the housing market did fall off. On interest rates, Mr. Blalock said there was still a slightly inverted yield curve, short-term rates are staying steady, and inflation has been under control at the 2.5% level. He said that, in terms of the equity domestic market, the S & P was up 6.7% for the quarter and 15.8% for the year; small caps were up during the quarter and year, at 8.9% and 18.4%, respectively; value has outperformed growth, which continues to be consistent for the last seven years. Mr. Blalock said that Blair will be here today to report on the international side, and briefly talked about the sector weights. On fixed income, he said the Lehman Brothers Aggregate Index was up 4.3% for the last year, and he talked about the individual sectors. Mr. Blalock reported that international equities have continued to do well in the local terms, with EAFE up 10.4% for the quarter being a combination of both the local returns and currency. He stated that in 2006, the U.S. dollar was depreciating against the Euro, which is adding the positive 4.3% for the quarter, and appreciating against the yen, so that shows a negative currency return for the U.S. investor in that market. Turning to page 22, Mr. Blalock pointed out that for the quarter ERS is up 6.3% and 6.2% net and last year 15.1% net. He said on the attribution side he felt allocation was helping more than manager selection, although ERS did have good manager selection and both DFA and Artisan did well, and then the international managers were second quartile type performers in aggregate. Mr. Blalock said fixed income had positive performance again, but the universe did not make as big of a difference relative to the total fund ranking.

Mr. Rick indicated that Mr. Kochis from the Townsend Group was unable to make it to Milwaukee due to weather conditions in Cleveland so he would briefly talk about a few key points in real estate after ERS' presentation. He reported that at the end of the year, the Fund's asset allocation was within investment guidelines and continues to have an overweight to its equities portfolio. Mr. Rick stated that both the domestic and international equity allocations experienced strong market returns during the 4th quarter, which contributed to the overweight, and a large amount of the overweight in domestic equities is due to our passive S&P 500 index account managed by Northern Trust.

He said the chart on page 4 shows that at the end of 2006, the fund had a market value slightly over $5.07 billion, a net increase of approximately $250 million from the end of the 3rd quarter. Mr. Rick said page 5 shows that since the beginning of the year, the fund gained $690 million and, when netted against the $238 million paid out in operating expenses and payroll, and the receipt of $35 million in contributions, there is net market gain of about $487 million compared to the end of 2005. He said that for the quarter, the Fund returned 6.3%, compared to 5.8%, and for 2006, the Fund outperformed by about 140 basis points. Mr. Rick talked about the Fund's information ratio, and 1.5% tracking error, which is similar to the amount of active risk that an Enhanced Index manager would display. He said that during the past 10 years, the Fund has earned 1.8% annualized excess return. Discussion ensued.

Mr. Rick talked about the relative investment performance of ERS' domestic equity managers as of December 31, 2006. Discussion ensued with respect to the domestic equity composite. Mr. Rick reported that ERS' 4th quarter performance was 6.8%, and he talked about the 5-year performance and statistics, and the domestic equity versus the universe. Mr. Rick stated that during the 4th quarter DFA outperformed; slightly outperformed for 1 year, and the 3 and 5 years show significant outperformance. Mr. Rick also talked about DFA's small cap value 5-year performance and statistics. He reported that Earnest Partners has struggled this last year underperforming over all three time periods, but their benchmark was pretty solid during the last year. Discussion ensued with respect to Earnest's performance.

Mr. Silber reported on the international equities stating this was the top performing composite of the Fund during the 4th quarter, having a return of 11.5% versus its benchmark, MSCI EAFE, return of 10.4%. He said all international equity styles produced double digit returns during the 4th quarter, with emerging markets and international large cap value stocks leading the way with returns of 17.6% and 11.8%, respectively. Mr. Silber stated the composite has outperformed its benchmark in all time periods shown, while taking slightly more risk than the benchmark. He said over the last 5 years the international equities have provided impressive absolute returns of 16.9% annualized, outperforming the benchmark by 1.9%. Mr. Silber talked about risk and the international equity versus the universe. He said Brandes 4th quarter return was 10.6%, slightly outperforming its benchmark return of 10.4%, they ranked near the median and have been a top quartile manager in all other time periods. Mr. Silber reported that over the last 5 years Brandes has produced annualized returns of 19.4%, outperforming its benchmark returns by 4.4%.

He said that William Blair outperformed their benchmark in the 4th quarter, with a return of 11.9%, or 70 basis points above their benchmark, and ranked in the top quartile and top half of its universe since ERS has hired them. Mr. Silber said that William Blair is here today to present, and he briefly talked about the firm. He stated that Blair's absolute return over the last three years is 20.8%, 1.0% less than their benchmark annually. Mr. Silber said that in April 2006, ERS hired DFA for an international small cap value mandate, and during the 4th quarter they had a return of 13.7%, significantly outperforming their benchmark return of 11.5%. He said DFA ranked near the median of their universe, and they are outperforming their benchmark while taking less risk. Mr. Silber said that since inception DFA has had a return of 10.0%, which is 7.7% above their benchmark.

On fixed income, Mr. Silber said this portfolio has a return of 2.0% during the 4th quarter, outperforming its benchmark return of 1.2%, and Loomis-Sayles was mostly responsible for that outperformance. He said that the composite has significantly outperformed their benchmark during all time periods, while being compensated for taking additional risk. Mr. Silber reported that over the last 5 years, the fixed income portfolio has generated solid returns of 6.8%, outperforming its benchmark return of 5.1%, and have been in the top quartile in all time periods shown, and are being compensated for the risk. He said that Loomis Sayles had a 4th quarter return of 2.9% versus the benchmark return of 1.2%, and over the last 5 years, Loomis has had an annualized return of 9.2%, outperforming their benchmark return by 4.1% per year. Mr. Silber said Reams Asset Management performed in line with their benchmark during the 4th quarter with a return of 1.3% versus their benchmark return of 1.2%, and Reams ranks in the top half of their universe for all time periods shown, except in the Mercer US Fixed Core Opportunistic universe, where they ranked in the 4th quartile during the quarter. Brief discussion ensued. Mr. Silber said over the last 5 years Reams has had an annualized return of 5.4%, slightly above the benchmark return of 5.1%. He said the estimated January 31, 2007 market value of the Fund is $5.10 billion, with ERS having a 1.0% return versus the benchmark return of 1.1%.

The Townsend Group Presentation. As a matter of information, Committee members received a presentation booklet submitted by the Townsend Group. As stated earlier in the meeting, Townsend was unable to present today due to weather conditions in Cleveland.

William Blair Presentation. As a matter of information, Committee members received a copy of a presentation booklet from William Blair. Mr. Rick provided a brief background on William Blair. Ms. Stevens updated the Committee on the firm stating William Blair has $42.9 billion in assets under management. She talked about the different styles, products, and the portfolio team. Mr. Greig talked about William Blair's investment philosophy and international growth portfolio characteristics. He said that the average holding has shown a 5 year earnings per share growth rate between 18 and 22 percent, which is somewhere around double the growth rate of the underlying benchmark in earnings per share. He said William Blair generally sees reinvestment rates on capital in the neighborhood of 50 percent higher. He said an approach like William Blair's will generally yield success in terms of finding companies that will be leaders in their peer group, but growth investing does have a cyclical element in terms of growth versus value, and he talked about these cycles.

Mr. Greig talked about the market performance stating the good performance of emerging markets was a significant benefit to William Blair's performance. He said another factor is how badly Japan did after an outstanding 2005, and, in particular, the growth component of the Japanese market was hit particularly hard. Mr. Greig said William Blair came out of the year in a very strong state cyclically and in terms of market valuations and return prospects. He said they are continuing to see the benefits of very strong corporate performance throughout the world internationally. Mr. Greig continued to talk about the market performance. He talked about ERS' current positioning of the portfolio, stating no extreme changes have been made. Lengthy discussion ensued.

(William Blair was excused at 10:25 a.m.)

Mr. Rick stated again that Townsend was unable to attend and he pointed out a few things Mr. Kochis would have touched on. Using the presentation booklet from Townsend, Mr. Rick said the performance for the real estate portfolio for the quarter show before fee returns of 4.7%, after fees 4.0%. He said looking at the 1 year number as of September 2006, Townsend had a return of 24.3%, gross of fees, compared to the benchmark return of 17.6%. Mr. Rick said not much progress has been made in getting up to the 7% total plan assets partly because ERS has been selling assets, but there are commitments out there of $114 million. He briefly talked about several properties that ERS had sold in 2006. Brief discussion ensued.

Value Added Report. As a matter of information, Mr. Rick provided a handout "Active Management versus Passive Analysis 10-Year Analysis 1/1/97 – 12/31/06". Mr. Silber said that this Committee has made a request for staff to provide an update on how the Fund's composites have performed versus their respective benchmarks. He said the handout presents a 10-year analysis of the Fund's returns, compares them to their benchmark returns, and estimates the benefit in dollars for the Fund's past 10 years' worth of decisions. Mr. Silber said this shows the return each composite has achieved annualized over the last10 years. He said this is compared to how the Fund would have done had it just invested in its blended benchmark in all index funds, which track the benchmark exactly, minus very small fees. Mr. Silber said the following two columns compare what the value of a dollar invested 10 years ago in both MERS' composites versus what a dollar investment would have been worth in just index funds. He said the last column provides a rough estimate, in dollars, of how the Fund has benefited, based on its decisions to hire active managers versus investing in all index funds.

Mr. Silber stated that all three composites have outperformed their respective benchmarks. He reported that domestic equity has had an annualized return over the last 10 years of 9.9%, net of fees, versus the Russell 3000, which has had a return of 8.6%, in dollar terms this has added approximately $285 million of additional fund assets. Mr. Silber said the international composite, net of fees, has returned 11.2%, which has outperformed the EAFE return of 7.65%, and in dollar terms, this had lead to an additional $223 million in Fund assets. He reported that the fixed income composite has outperformed its benchmark by an annualized 1%, net of fees, which translates into approximately $103 million in additional dollars for the Fund. Mr. Silber said, in total, that based on the Board's decision to hire the managers we have as opposed to going totally into index funds, there is approximately $611 million more in the Fund.

He said the table at the bottom shows that a little over 10 years ago the Fund decided to invest in international equities and the impact shows the total MERS equity return for the Fund has been 10.76%, net of fees, versus the Russell 3000 with an 8.6% return, which translates into an approximate gain of $612 million . Mr. Silber said there are 4 charts included in the handout that show graphically the alpha generated by MERS' equity and Fixed Income composites by year as well as each respective composite's growth of a dollar chart. Brief discussion ensued.

There being no further business, Mr. Morics adjourned the meeting at 11:07 a.m.

Martin Matson
Acting 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 Employes' Retirement System, City Hall, 200 E. Wells St., Room 603.)