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

Minutes of the Investment Committee Meeting
held November 12, 2008

The meeting was called to order at 9:09 a.m.

Committee Members Present:	John Barmore William C. Carey Larry Holland W. Martin Morics Michael J. Murphy, Chair Ron Walter
Committee Members Not Present:	Thomas Fischer (excused) Sebastian Raclaw
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 Ben Rode, Pension Investment Intern Kathleen Conway, Board Stenographer

Others Present: Doug Kryscio, Mercer Investment Consulting; Marina Carlson, Craigh Cepukenas and David Heiny, Artisan Partners; John Phillips and Vicki Fuller, AlianceBernstein; Rob Kochis and Kevin Rivchun, The Townsend Group; Beth Cleary and Rudy Konrad, City Attorney's Office, and Gary Brazgel, Retiree.

Equity Structure Recommendation. As a matter of information, Committee members received a copy of Mercer's Equity Structure Review, dated November 12, 2008. Mr. Kryscio stated that for the last 14 months the Committee has been involved in an asset liability study. In August 2008 the Committee agreed to move forward, and the first step is the equity structure review. If the Board does vote to proceed with the new allocation, which is taking alternatives from 7% to 15%, as an example, we need to have somewhere to get the other 8%. Mr. Kryscio stated that this would be a two to three year program. He indicated that the Board also needs to be comfortable with what we have before moving forward and he talked about some of the issues involved; ERS' current policy and the recommended mix 6D. This Board needs to think about the risk tolerance; has it changed based on what has happened year-to-date, and how we position this Fund going forward.

Mr. Kryscio stated in his 30 years in this business, he has never seen where everything is so depressed in valuations. He did not think it is going to be a V shaped correction going forward, but he did think it will get better, and the purpose of this is to turn the tide going forward. Mr. Morics asked if Mr. Kryscio's view has fundamentally changed on any of the sectors that the Board has looked to investing in. Mr. Kryscio answered in the negative, but stated one change may be the consolidation of the hedge fund market. Lengthy discussion with respect to the asset allocation study.

Mr. Kryscio gave background information on the Asset Liability Modeling results. He indicated the purpose of the equity structure review is to examine the investment manager structure; review number of managers; review active vs. passive structure; emerging market, and adding a global equity mandate. Once this process is finished, the investment policy will be revised, and Mercer has confirmed that the current benchmarks are still appropriate. He talked about the portfolio structure: active vs. passive; fees; current portfolio structure; the domestic and international equity allocations; and emerging markets exposure. Mr. Kryscio stated that the recommendation from Mercer is a global mandate and he talked about percentages and dollars. Mr. Silber handed out the Asset Allocation Comparison Estimated Values as of October 31, 2008. Mr. Kryscio went over the comparisons, and stated that phase I of Mercer's recommendation would be a global equity manager search for 2 managers: 1 value, 1 growth. Staff would work with Mercer to start the transition of moving money away from domestic equity to international equity, which may be a 12 to 18 month process. He said if the Board is comfortable with what Mercer is proposing today and wanted to approve it, he would suggest starting the global manager search in January 2009, so once that is finished, he recommends funding those managers soon after selection. Mr. Kryscio stated that during the 12 to 18 months we would be moving money away from the likes of BGI and giving it to Brandes, William Blair, and DFA. After discussion, it was moved by Mr. Morics and seconded by Mr. Carey, that based upon review the Committee continues with our prior recommendations and proceed forthwith. After further discussion, the motion prevailed by the following roll call vote: AYES: Messrs. Barmore, Carey, Morics, Walter, Murphy. NOES: Mr. Holland.

Artisan Partners Presentation. As a matter of information, Committee members received a presentation booklet, dated September 30, 2008. Mr. Thomas handed out an updated performance chart and briefly talked about Artisan. Mr. Heiny made opening comments and briefly talked about the firm. Ms. Carlson went over Artisan's investment philosophy and process. Mr. Cepukenas talked about security level contribution to return. Ms. Carlson talked about Artisan's actions before and after this market environment with respect to earnings growth assumptions. Mr. Cepukenas talked about the portfolio characteristics and Artisan's consistency. Mr. Heiny directed the Committee's attention to Tab III and reported that the third quarter of 2008 was a good relative quarter as they picked up some performance that had been lost in the first half of the year. Mr. Cepukenas stated that Artisan is at a very low point of price and intrinsic value. Lengthy discussion ensued with respect to the current market environment.

Alliance Bernstein Presentation. As a matter of information, Committee members received a presentation booklet, dated November 11, 2008. Mr. Silber handed out an updated performance chart and briefly talked about Alliance Bernstein. Ms. Fuller stated that Mr. Phillips has a long history of value investing at Bernstein and has been involved in ERS' portfolio since inception and she turned the presentation over to him. Mr. Phillips stated that over time we have seen periods of great stress in the markets and acknowledged that this is one of the toughest times in the markets that any of us, even with long histories, have ever experienced. It has been very tough for value as a style since June 2007. He said Bernstein's performance has been disappointing over the last 15 months and has taken away any performance premiums. Mr. Phillips stated that when the crisis hit, value opportunities defined as the best 20 percent of the bargains across all sectors fell pretty much in common so that their efforts to diversify in response to the below average opportunity did not help.

Mr. Phillips did acknowledge that Bernstein did make some mistakes in some of the investments in finance. While the stress and anxiety is particularly centered in the financial area, the other 75 to 80 percent of ERS' portfolio is in bargains that are comparable to what exists in finance. He indicated that across the U.S. the debt to capital ratio fell from about 48 percent to 42 percent. While the interest coverage of the typical non-financial company improved over the period, the stocks Bernstein owns for ERS have interest coverage double that of the typical non-financial company. Mr. Phillips stated we are in an environment that is unprecedented in a number of respects, but the portfolio is sound. He noted there is the potential for the portfolio, if it were to sell at an average price, to go up about 2.5 fold without including dividends.

He talked about AIG stating it was a downward spiral as they needed to mark to market securities that were highly illiquid, and then the rating agencies validated the downward spiral by requiring them to post more collateral. Mr. Phillips stated that basically what was a bridge loan was advanced at taking 80 percent of the company rather than an injection of a preferred stock at half the interest rate for warrants for a small portion of the company. He said that the portfolio did suffer from some mistakes Bernstein made, but they have learned from those mistakes. That said, Mr. Phillips stated that the positioning of similar companies is no longer the case in this portfolio. He said the rest of Bernstein's financial holdings are in larger banks and insurance companies, which are selling at three to six times long-term estimates that will actually emerge as leaders and much stronger in the new environment. Mr. Phillips indicated the rest of the portfolio outside of finance is in companies that are on sale, and Bernstein is going to pursue those opportunities with an unwavering commitment.

He provided some perspective on their performance summary. Mr. Phillips also went over ERS' portfolio since inception. He stated that Bernstein is truly excited about the bargain opportunity to capture not only what they have given up in absolute performance, but to re-establish the premium. The short term performance shows the impact of financials, as well as consumer stocks, in detracting from performance. Mr. Phillips indicated that not all financials were negative and Bernstein saw contributions from holdings in companies such as J. P. Morgan. He talked about the shocks and problems along the way; every one of them viewed as very harsh conditions; the subsequent investment returns for the industries that were most severely affected, and the payoff period. Mr. Phillips stated the payoff period is very likely to occur sometime over the next two years. He talked about the equity-risk premium, and the rolling three-month tracking error. Mr. Phillips highlighted that the bargains are very wide spread and talked about the various value opportunities. He said Bernstein regrets the mistakes that they made and their inability to protect ERS. He did emphasize that looking forward Bernstein feels they have an enormous opportunity to restore what was lost and deliver the premium. Lengthy discussion ensued.

(Mr. Walter left the meeting at 11:08 a.m. and Mr. Holland stepped out at 11:44 a.m.)

Mercer Review. Mr. Murphy advised that the Investment Committee of the Annuity and Pension Board may vote to convene in closed session on this item, as provided in Section 19.85 (1) (e), Wisconsin State Statutes, for deliberating or negotiating the purchasing of public properties, the investing of public funds, or conducting other specified business, whenever competitive or bargaining reasons require a closed session. The Investment Committee will then reconvene in open session following the closed session. It was moved by Mr. Morics and seconded by Mr. Carey, to convene in closed session. The motion prevailed by the following roll call vote: AYES: Messrs. Barmore, Carey, Morics, and Murphy. NOES: None.

The Committee convened in closed session at 11:45 a.m. and reconvened in open session at 11:59 a.m.

Townsend Group Real Estate Presentation and Recommendations. As a matter of information, Committee members received copies of a Performance Measurement Report Second Quarter 2008, and a Real Estate Investment Program: Funding and Compliance, dated November 12, 2008. Mr. Silber handed out an updated performance chart and briefly talked about the Townsend Group. Mr. Kochis introduced Kevin Rivchun, who joined Townsend earlier this year and works on ERS' account with him. Mr. Kochis indicated that private market real estate numbers lag 90 days, so Townsend is just starting to get in the numbers for September 30 performance. He stated he would talk about Townsend's most current performance as of June 30, 2008. Also before the Committee today are rebalancing initiatives that Townsend thinks ERS should consider for the real estate program. Mr. Kochis stated that Townsend is out of compliance today based on the fact that ERS' overall plan asset values have shrunk, and real estate values have held up relatively well. As a result, Townsend is at about 11 percent in real estate, with a permissible range of about 5 to 9 percent, so we need to talk about options with the Committee for rebalancing.

Mr. Kochis stated that ERS has about $390 million invested in real estate as of June 30, 2008. The current environment today is that real estate is starting to feel the impact of the credit crunch. He reported that ERS had its first negative quarter of performance in five years, which is primarily a mark-to-market phenomenon. To put that into context, in the second quarter ERS' portfolio generated $4.6 million of profits, but at the same time the values were written down by $6 million. He said what Townsend is seeing right now is that the income return from real estate is being outstripped by revaluing of the properties. Mr. Rivchun briefly talked about ERS' five year performance.

Mr. Kochis mentioned that over time the plan is to try and grow the international exposure, possibly up to 20 percent of ERS' program. He stated that ERS has 23 funded investment accounts in real estate, managed by 16 managers. Two of those accounts are liquidated with just a small cash position left. Mr. Kochis said that the core strategy is ERS' foundation and safety net in these market times as they are high quality substantially leased buildings that are generating primarily income-oriented returns. The specialized strategies are focused on everything from some international investing to development projects, to focusing on specialized property types. He indicated that 90 percent of ERS' portfolio is composed of four different property types: apartment buildings, retail plazas or malls, industrial complexes such as warehouse and distribution, and office buildings. Mr. Kochis also noted that less than 5 percent of ERS' portfolio was in the residential housing sector.

He highlight that Townsend was carefully looking at the Colony Fund, which has taken some significant write-downs; they have lost 50 percent of the two-thirds of what they have invested. This is primarily due to them having bought a stake in Carrefour, a public traded retail company in Europe, which is second in size globally to WalMart in terms of being a retailer. Another Colony Fund investment is Station Casinos, which manages a number of casino properties in Las Vegas and that sector has also been hit hard by this economic downturn. As for Carrefour, Mr. Kochis stated that Townsend does not expect the public markets to bounce back soon, but Townsend does have a lot of confidence in the company and the underlying real estate, so long-term those losses are going to be earned back.

Mr. Kochis noted that ERS has had overall good performance over the long term and the portfolio is feeling the impact of this downturn. He indicated ERS will probably feel more impact as the third quarter values roll in, and Townsend expects the fourth quarter to be a rocky quarter in real estate. Discussion ensued.

Mr. Kochis directed the Committee's attention to the next booklet. He said that the real estate portfolio is currently at about 11 percent and Townsend's strategic range is to keep ERS between 5 and 9 percent, with a 7 percent target. Mr. Kochis noted that what Townsend wants to do is shrink the portfolio, but continue to recycle some of that capital in to the market at a time when they expect there to be some really good buying opportunities. He reported that when the market severely corrected in September and October of this year, Townsend initiated a series of withdrawals from the funds where there was some liquidity, which are the open end funds. Mr. Kochis stated this means that the manager would permit ERS to redeem the capital with notice and subject to cash available to pay you out. So Townsend blanket redeemed 100 percent of your capital from all of those funds, or at least put in a request to get that money back. He talked about one separate account property, which is on the market today. Mr. Kochis went over ERS' real estate funding status and their plan to reduce the portfolio within its strategic range.

(During the above presentation, Mr. Holland left the meeting at 12:17 p.m.)

The meeting convened as a sub-committee at 12:17 p.m.

Mr. Morics called for a break at 12:45 p.m. The sub-committee reconvened at 1:10 p.m.

Acceptance of Barclays Global Investors Due Diligence Report. As a matter of information, Committee members received a copy of a memorandum from Mr. Silber, dated November 5, 2008. Mr. Silber stated that he, Mr. Murphy, Mr. Allen and Mr. Kryscio visited at the end of August. They met with managers from the Alpha Tilts strategy, the fixed income strategy and the research team. He reported there have been no changes in their investment philosophy or process. Mr. Silber discussed their underperformance in 2007 in the Alpha Tilts strategy. Discussion ensued. Mr. Morics indicated this would be approved at the Board meeting due to the lack of a quorum.

Rebalancing Policy Recommendation. Mr. Kryscio handed out a memo, dated November 5, 2008. Mr. Kryscio talked about the rebalancing policy recommendation due to the Fund being out of policy ranges in certain asset classes. Mr. Morics asked Mercer to provide a written recommendation for rebalancing by November 20, 2008 Board meeting. Discussion ensued.

3rd Quarter Performance Report. As a matter of information, Committee members received presentation books from Mercer and ERS staff. Mr. Rick reported that as of September 30, 2008 the Fund's value was $4.17 billion, with the Fund losing $55 million from the end of Quarter 2 to the end of Quarter 3. He indicated that for the 3rd quarter the Fund was down 10.4 percent versus the benchmark return of -8.3 percent. Mr. Silber reported on the domestic equity composite stating it had a -10.5 percent return during the 3rd quarter underperforming its benchmark return of -8.7 percent. On relative investment performance he noted that a majority of the Fund's domestic equity managers underperformed during the quarter led by Bernstein and Turner. Mr. Silber stated that Artisan and Earnest both outperformed their benchmark.

He reported that the international equity composite performed worse than the U.S. markets during the 3rd quarter with a -21.4 percent return, underperforming the benchmark by 80 basis points. Discussion ensued. On relative investment performance Mr. Silber reported that Brandes and DFA outperformed their respective benchmarks, while Blair underperformed its benchmark by 5.7 percent during the quarter.

Mr. Thomas reported on the fixed income composite stating for the 3rd quarter it had a -4.9 percent return, which underperformed the -0.5 percent return of the benchmark. On relative investment performance Mr. Thomas reported that the fixed income managers have underperformed in all time frames except the five year numbers. One bright side is Loomis' outperformance in the five year time frame; and is the main driver for the Fund's outperformance over that same time frame. He reported that through October 31, 2008 the Fund's value was $3.54 billion, with a -16 percent return, which is approximately 240 basis points of underperformance. From the 1st through 3rd quarters the Fund returned -17.2 percent, with 300 basis points of underperformance, and year-to-date the Fund returned -30.5 percent. Discussion ensued.

Securities Lending Update. Mr. Thomas handed out a memo, dated November 12, 2008. He stated that ERS has $3.9 million of unrealized losses and Northern Trust has contributed $460,000 to offset some of the $3.9 million. As a result of the mark-to-markets in the collateral pool, Northern has restricted exiting the Securities Lending Collateral pool. Mr. Thomas noted that Northern has given three options to the participants who wish to get out: in-kind distribution, a staged withdrawal or maintain program. He indicated that staff and Mercer are recommending maintaining the program with the hopes of recovering the unrealized losses. The A & O Committee approved extending the contract with Northern Trust for one year because ERS wants time to allow the issues with the credit markets to work themselves out before making any kind of movements.

Mr. Thomas reported that year-to-date ERS has $1.7 million in revenue from Securities Lending. October's estimated number is $481,000, which brings the total to $1.9 million in revenue. Mr. Rick talked about Northern's new conservative approach, which is still in line with their investment guidelines. He stated that ERS has not lost any securities as everything came back. From a net prospective, we are short about $1.4 million, which is what ERS would owe Northern to make them whole if we left today. Discussion ensued.

There being no further business, Mr. Murphy adjourned the meeting at 2:01 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 Employes' Retirement System, 789 N. Water Street, Suite 300.)