

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

Minutes of the Investment Committee Meeting
held November 12, 2009

The meeting was called to order at 9:12 a.m.

Committee Members Present: John Barmore
 Tom Fischer
 W. Martin Morics
 Ron Walter
 Michael J. Murphy, Chair

Committee Members Not Present: William C. Carey (excused)
 Angela Henschel (excused)
 Larry Holland (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
 Kathleen Conway, Board Stenographer

Others Present: Beth Cleary, City Attorney's Office; Doug Kryscio and Patty Hafner, Mercer Investment Consulting; John Phillips and Vicki Fuller, AllianceBernstein; and Rob Kochis and Kevin Rivchun, The Townsend Group.

Q3 2009 Performance Review. As a matter of information, Committee members received copies of Mercer's Board Report Periods Ending September 30, 2009 and ERS' 3rd Quarter Performance Report. Mr. Kryscio talked about the U. S. Capital market environment, and the economic front. He stated that things are much better than one year ago, but we still have a long way to go as we are not out of the woods yet. Brief discussion ensued. Mr. Rick talked about ERS' asset allocation; and stated the Fund Value of Assets for the third quarter of 2009 was \$3.91 billion, which is about \$475 million more net than the beginning of 2009. He stated that as of September 30, 2009, the Fund had: capital market gains of \$647 million; paid out \$195 million in payroll and expenses; and received contributions of \$23 million. Mr. Rick reported the return for the third quarter was 13.1 percent or 130 basis points above the benchmark, and year-to-date ERS is 420 basis points over the benchmark. He talked about the Total Fund 5-year performance and statistics, and the Total Fund vs. the Universe.

Mr. Silber talked about the domestic equity managers stating that from May 2005 through September 2009, all the managers' fall within their expected styles. He reported that all the major US indices had double digit returns during the quarter, and every sector was up during the quarter. Mr. Silber stated the composite performed well returning 17.6 percent and outperformed its benchmark by 130 basis points during the quarter. It is also performing well year-to-date and outperforming over the 1 year time period. Mr. Silber talked about the domestic equity 5-year performance and statistics, the domestic equity composite vs. the universe, and the relative investment performance for the domestic equity managers as of September 30, 2009.

Mr. Silber reported that international equity markets also performed very well during the third quarter. Although the composite had very good absolute returns, it underperformed its benchmark by 1.0 percent. He said the composite is still outperforming year-to-date and over all other time periods. He also talked about the international equity 5-year performance and statistics, international equity composite vs. the universe, and the relative investment performance for the international equity managers as of September 30, 2009.

Mr. Thomas indicated that for the third quarter the fixed income portfolio had an 8.7 percent return versus the 3.7 percent return for the benchmark. Year-to-date the fixed income portfolio was outperforming the benchmark by 17 percent, and over the long term it has managed to outperform. He reported that over the last five years the fixed income portfolio has outperformed the benchmark while taking additional risk. Mr. Thomas stated that for relative performance both Loomis and Reams outperformed their benchmarks in the third quarter which is reflective of the fixed income portfolio as a whole outperforming its benchmark. He indicated the driver behind Loomis' outperformance was their holdings in corporate, high yield and non-dollar holdings, as well as no allocations to treasuries. Mr. Thomas stated that Reams' outperformance was driven by their holdings in investment grade corporates and high yield corporates. He noted that Barclays continues to mirror the performance of the benchmark.

Mr. Thomas handed out an updated Performance Update stating that through November 11, 2009 the Fund is up to \$3.96 billion; September year-to-date ERS returned 19.7 percent, which outperformed the benchmark by 420 basis points; the estimate for October is a -1.6 percent return; the estimate for November month-to-date is 4.1 percent return; and the estimate for November year-to-date is 22.5 percent return, which is outperforming the benchmark by 420 basis points.

Approval of Downgraded Bonds. As a matter of information, Committee members received a copy of a letter from Reams, dated November 6, 2009. Mr. Silber talked about the two downgraded securities before the Committee: Fannie Mae and Freddie Mac. After discussion, it was moved by Mr. Morics, seconded by Mr. Walter, and unanimously carried, to approve Reams' request to hold the two securities for an additional 90 days.

Approval of Northern Trust Custody Extension. Mr. Rick handed out the Agreement Amendment/Northern Trust Company Restated and Extended Agreement provided by the City Attorney's Office, dated November 10, 2009. Mr. Rick stated that back in 2008 ERS started an RFP process to review Northern Trust for the custody agreement. However, in September 2008 things started happening so ERS placed the RFP on hold due to Securities Lending issues. Mr. Rick stated that in June 2009 Mercer indicated that ERS should suspend the RFP process and go out for a one or two year extension with Northern Trust. Mr. Rick stated it is staff's recommendation, along with the assistance of the City Attorney, to extend the agreement for three years. It was moved by Mr. Morics, seconded by Mr. Fischer, and unanimously carried, to approve the extension to the custody agreement with Northern Trust.

Approval of Due Diligence Reports.

(As a matter of information the agenda was taken out of order.)

Brandes Investment Partners. As a matter of information, Committee members received a copy of the memorandum from Mr. Silber, dated November 6, 2009. Mr. Silber handed out an updated performance chart. He indicated that Brandes was one of the few active managers that outperformed for the Fund last year. Mr. Silber stated that Brandes has generated significant added value to the Fund since being hired by consistently exceeding their benchmark over 3-year rolling time periods, and the majority of time periods they have exceeded their guideline requirement of excess performance, net of fees, of over 200 basis points.

Dimensional Fund Advisors. As a matter of information, Committee members received a copy of a memorandum from Mr. Silber, dated November 6, 2009. Mr. Silber handed out an updated performance chart. Mr. Silber stated that over the last couple of years DFA has made a small enhancement to their process by incorporating a momentum filter into their strategy that tries to prevent selling the winners too early and also buying the falling stocks too early. He noted that DFA has indicated this has helped their relative performance over the most recent years. Mr. Silber stated DFA's performance has been excellent in 2009. He indicated that staff will continue to monitor the assets under management for the strategy: \$8.2 billion in US small cap strategy and \$6.6 billion in the international strategy, which is higher than the typical small cap manager. Mr. Silber stated that DFA does use this to their advantage in terms of trading where they are able to add value because of their volume and holdings, as well as being very well diversified. He briefly talked about the move of the DFA offices.

It was moved by Mr. Morics, seconded by Mr. Fischer, and unanimously carried, to approve the due diligence reports for Brandes and DFA.

(At this time the agenda was taken in order.)

Update of Asset Liability Study Implementation Roadmap.

Investment Policy Allocation Update and Recommendation. As a matter of information, Committee members received a presentation booklet "ALM Study – Implementation Update", dated November 12, 2009, and a memo from Mercer, dated November 12, 2009. Mr. Kryscio briefly talked about the background of this project. Ms. Hafner stated the major outcomes of the study are reducing the current domestic equity allocation, while increasing the international equity allocation; the fixed income allocation will remain the same; and increasing the alternative assets from 7 percent to 15 percent. She talked about the asset allocation and compared it to June 30, 2009.

Mr. Kryscio stated that, technically the Board has not approved recommended Mix 6D on slide 3, but the Board has given Mercer permission to move toward that Mix. He said Mercer's recommendation is that if they need cash for anything staff keep in mind Mix 6D. Mr. Kryscio said that if you are underneath 45 percent domestic equity, Mercer wants to make sure the Board is comfortable to move within that range. Also, he stated that once they get the contracts signed for the global equity mandates, ERS has to take the money from somewhere, and Mercer is suggesting BGI. Discussion ensued. Ms. Hafner talked about the progress for the third and fourth quarter 2008 in the equity

structure review and the fixed income review. She indicated that due to the market at this time last year, and the lack of liquidity in the markets, the fixed income search was put on

hold. Ms. Hafner stated that at this point, Mercer is recommending that after the private equity and small cap growth searches, the fixed income manager search would commence. She briefly talked about the progress for the first and second quarter 2009 and the selections of GMO as the Global Value Equity manager and MFS as the Global Growth Equity manager.

Ms. Hafner stated that the progress for the third and fourth quarter 2009 is further education on private equity managers, as well as bringing a list of ten to twelve private equity managers that Mercer is looking at for hiring two to three managers for a total of \$75 to \$100 million in assets. She stated Mercer has narrowed that list down to five managers, but Mercer is also recommending putting the private equity manager search on hold until after the small cap growth search. Ms. Hafner stated that over the next two years, after finishing the small cap growth search, Mercer is looking at the private equity search and then the fixed income search. She stated at the end of 2010, Mercer would be looking at conducting a commodity manager search and an infrastructure manager search.

For the first quarter of 2011, Ms. Hafner indicated that Mercer would look at conducting a hedge fund fund-of-funds manager search, followed up in the second and third quarter of 2011 by another private equity and hedge fund search. It was moved by Mr. Morics, seconded by Mr. Walter, and unanimously carried, to accept the Investment Policy Allocation update.

Approval of Small Cap Manager Finalists. As a matter of information, Committee members received a copy of a memo from Mercer, dated November 12, 2009. Mr. Murphy advised that the Investment Committee 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 public business, whenever competitive or bargaining reasons require a closed session. The Committee may then reconvene in open session following the closed session. It was moved by Mr. Morics and seconded by Mr. Walter, that the Committee convene in closed session. The motion prevailed by the following roll call vote: AYES: Messrs. Barmore, Fischer, Morics, Walter and Murphy. NOES: None.

The Committee convened in closed session at 10:08 a.m. and reconvened in open session at 10:30 a.m.

Mr. Murphy indicated there was a motion to approve three small cap manager finalists to be reviewed at a later date. It was moved by Mr. Morics, seconded by Mr. Fischer, and unanimously carried, to approve three small cap manager finalists.

(At this time the agenda was taken out of order.)

Approval of Private Equity Manager Finalists. As a matter of information, Committee members received a copy of the memo from Mercer, dated November 12, 2009. Ms. Hafner talked about the five finalists for the private equity manager search and next steps. After discussion, it was moved by Mr. Fischer, seconded by Mr. Walter, and unanimously carried, to approve the private equity manager finalists.

Approval of Global Equity Investment Manager Contracts. Asset Transition Plan.

Mr. Rick stated the investment staff has met with the outside experts and the City Attorney's Office and went over the agreement and talked about any areas that may be in conflict with the outside expert. Ms. Cleary indicated the contracts are in negotiations and things are going fairly smooth according to the outside counsel. She stated they are looking to wrap things up with MFS early next week and GMO shortly thereafter. Mr. Rick stated he would like to bring these contracts back to the Investment Committee's December meeting. Discussion ensued with respect to the asset transition plan.

AllianceBernstein Strategy Update. As a matter of information, Committee members received a presentation book "Third Quarter 2009 Current Strategy Review", dated November 12, 2009. Mr. Silber handed out an updated performance chart. Mr. Silber introduced Ms. Fuller and Mr. Phillips and gave some background information on AllianceBernstein and performance. Ms. Fuller talked about assets under management; commitment to research; continuity in investment leadership; and year-to-date relative return flagship value services. Mr. Phillips talked about the investment policy group changes with the addition of Gerry Paul, replacing John Mahedy, who left the firm about six weeks ago. He talked about Mr. Paul's background and experience. Turning to page 17, Mr. Phillips talked about Bernstein's US Strategic Value performance stating that from March through September 2009 ERS' portfolio is up 55 percent. He stated as we move past this period of grave concern Bernstein is very well equipped to deal with this sort of an environment as stress and anxiety create bargains. Mr. Phillips talked about the widespread stock selection; recovery being under way; is recovery sustainable; risk free assets; corporate earnings; financial, corporate balance sheets; uncertain earnings outlook; elevated opportunities; company-specific value opportunities; and Bernstein's holdings. Discussion ensued.

Mr. Murphy called for a break at 11:08 a.m. The Committee reconvened at 11:58 a.m.

(During the break Mr. Walter left the meeting at 11:08 a.m. and Ms. Cleary left the meeting at 11:30 a.m.)

Townsend Real Estate Portfolio Update. As a matter of information, Committee members received a presentation book "Performance Measurement Report Second Quarter 2009". Mr. Thomas handed out an updated performance chart. Mr. Kochis talked about the real estate market outlook; current correction; and liquidity in the market. Lengthy discussion ensued with respect to the liquidity in the market and lending. Mr. Kochis indicated that Townsend feels it will be at least two more years before real estate fundamentals begin to improve. He stated with weakening fundamentals and a capital market crisis that is not quite resolved, that suggests to Townsend that some of the themes we have talked about at past meetings such as focusing on good quality income that will be there for the next couple of years to help us ride through the storm. Mr. Kochis stated that Townsend wants to find ways to fill the liquidity gap that exists in the market today which is caused by the fact that the lenders are not lending, and there are a lot of owners in distress because they have mortgages either in default or coming due. He stated things Townsend is not doing today is buying

buildings that are vacant as you would be fighting an uphill battle to keep that building occupied and generating positive income.

Mr. Kochis talked about performance stating that ERS' program has lost about 40 percent of its value over the last year. He indicated that ERS' program was moving along very well, generating good performance above the benchmark since 2001. When this correction hit ERS has been hit a lot harder and faster than the benchmark. Mr. Kochis stated the NCREIF property index consists of about 6,000 properties that are institutionally held by tax exempt investors, with about \$200 billion worth of value. The differences between ERS' performance and the NCREIF property index is leverage and valuation discipline. He indicated that because of the challenges with the NCREIF index, Townsend teamed up with NCREIF in 2007-2008 and created some new indexes that reflected fund type investment structures. Mr. Kochis stated these new fund indexes are the most apples-to-apples comparison to ERS' portfolio and the way you invest, which is commingled fund structures, with more tactical strategies, value added and opportunistic strategies that use leverage. He indicated that ERS' performance has been holding up about as well as your peers in this correction. Lengthy discussion ensued.

Mr. Rivchun talked about ERS' investments such as Colony Investors VIII; Capmark Commercial Realty Partners and Partners II; CPI Capital Partners, and RREEF. Mr. Kochis talked about the three new initiatives for MERS: commit \$20 million to LaSalle Core Open-End Fund; \$20 million to Brookfield Real Estate Club Program; and \$5 million in RREEF Global Opportunity Fund II. Discussion ensued.

There being no further business, Mr. Murphy adjourned the meeting at 1:13 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.)