

20970a-2

POLICE AND FIRE RETIREMENT PLAN

Investment Committee Summary

THURSDAY

SAN JOSE, CALIFORNIA

MAY 21, 2008

Present:

Committee Members

Mark Skeen

Ken Heredia

Bret Muncy (arrived at 9:15am)

Also Present:

Russell Crosby -Director/Secretary

Scott Smith

-Hanson Bridgett, LLP

Tom Webster -Deputy Director

Allan Martin

-NEPC

Donna Busse -Staff

Kevin Tatlow

-NEPC

Ron Kumar -Staff

Daniel LeBeau

-NEPC

Udaya Rajbhandari -Staff

Mollie Dent

-Staff

Ceara O'Fallon -Staff

Cristin James -Staff

MEETING SUMMARY

RECOMMENDATIONS

- Approval to grant an Investment Policy exception for William Blair & Co. to increase their limit for investments in Emerging Market Equities from 25% to the lesser of 35% or two-times the MSCI ACWI ex-US Index weight of the International Equity portfolio managed by them.
- Approval to modify the Police & Fire Department Retirement Plan's Investment Policy Statement to include Credit Strategies, Absolute Return and Real Assets.
- Approval of the Plan's new Asset Allocation, Option A, as recommended by the Plan's Investment Consultant, NEPC.
- Approval of the Plan's Private Equity Strategy as recommended by the Plan's Investment Consultant, NEPC.
- Approval of the 2008-09 Work Plan.

APPROVAL ITEMS

1. Approval for the Secretary to negotiate and execute an agreement with Hanson Bridgett, LLP to provide investment related legal services for an amount not to exceed \$100,000.

Mr. Scott Smith was present to introduce himself to the Trustees. He is a Corporate/Tax Partner with 14 years of experience with the firm. He explained that Hanson Bridgett, LLP would handle general legal transactions,

review and negotiate investment contracts/side letters for the Plan.

Vice-Chair Heredia was concerned that there could be conflicts with Hanson Bridgett, LLP working for other City departments or one of the Unions.

Ms. Mollie Dent explained that the City Attorney's office monitors conflicts of interest and if one came up then the Trustees of the Board would be notified.

At their May 1, 2008 meeting, the Board delegated authority to the Investment Committee to approve hiring the Investment Counsel.

Motion/second/approved. (2-0) (Heredia/Skeen – Muncy absent)

- 2. Approval to grant an Investment Policy exception for William Blair & Co. to increase their limit for investments in Emerging Market Equities from 25% to the lesser of 35% or two-times the MSCI ACWI ex-US Index weight of the International Equity portfolio managed by them.**

Mr. Martin explained that William Blair is a good manager and that Emerging Markets is a good universe to invest. Nothing about this change would jeopardize the Emerging Market portfolio.

The Committee recommended that the Board approve this item.

Motion/second/approved. (3-0)

- 3. a) Approval to modify the Police & Fire Department Retirement Plan's Investment Policy Statement to include Credit Strategies, Absolute Return and Real Assets.**

The Committee recommended that the Board approve this item.

Motion/second/approved. (3-0)

- b) Delegate authority to the Investment Committee to select managers in asset classes based on the Investment Consultant's recommendation.**

The Secretary stated that this approval would give the Investment Committee the option to perform an on-site due diligence visit if necessary or to rely on the due diligence already performed by NEPC for new managers that will be added to the portfolio.

Vice-Chair Heredia expressed concern that the full Police and Fire Board should review this amendment to the guidelines for the Investment Committee.

Mr. Martin suggested that a transitional change be made to the way the Investment Committee operates until the Investment Policy can be rewritten or the Plan may not be able to hire new managers on a timely basis.

Member Muncy recommended that this item be deferred, the memo be rewritten to include the Investment Policy and then presented to the full Police and Fire Board at the June 5, 2008 meeting.

Mr. Martin stated that without streamlining the due diligence process, investment in Alternative Assets will be very difficult.

Motion/second/approved. (3-0)

4. Discussion and action on the Plan's Asset Allocation.

Mr. Martin stated that the general outlook of the market is unfavorable. The problems that started with the subprime industry will continue to spread. Higher volatility is expected. In order to protect against market downturn pressure the Plan should diversify and reduce exposure to US Equity and Core Bonds. Consider lowering volatility by seeking asset classes focusing on absolute return, and increased allocations to "real assets" and Private Equity.

Mr. Martin suggested that as a conservative start to making changes in the overall Asset Allocation, the Trustees should adopt the changes in Run A. This would add a 5% allocation to Credit Strategies, reduce the Real Estate allocation to 10%, increase Private Equity to 8%, add an Absolute Return allocation of 5% and add a Real Assets allocation of 5%. The goal of this target allocation would be to reduce risk and volatility in the fund while maintaining the current returns.

Member Heredia expressed concern over having Trustees make decisions about hiring managers in these new asset classes without some more education on particular investments.

Mr. Martin assured Member Heredia that NEPC would provide the necessary education on each asset before asking the Trustees to review new managers in those classes.

The Committee recommended that the Board adopt the Asset Allocation, Run A.

Motion/second/approved. (3-0)

5. Discussion and action on the Plan's Private Equity Strategy.

Mr. Kevin Tatlow explained that in order for the Fund to meet and maintain an 8% target allocation in Private Equity, the Trustees would need to invest \$100 million each year. The NEPC recommendation for vintage year 2008 would be to allocate \$10 million to Venture Capital, \$10 million to Growth Equity, \$30 million to Mezzanine, \$20 million to Secondaries and \$30 million to Distressed Debt.

The short-term objective would be to utilize secondary strategies to mitigate the impact of the "J-Curve". Long term objective would be to invest in venture, growth equity and buyout strategies, whose principal source of returns is capital appreciation.

The priority for transitioning into the new allocation would be to start by looking for Credit-related Strategies and Secondary opportunities.

Mr. Martin suggested that the Trustees use a "Best Ideas" strategy where NEPC would review opportunities in the market that are suited to this Plan, perform the necessary due diligence, then report back to the Committee with a list of the best opportunities in the market.

Member Heredia expressed concern that the new process of working with NEPC in selecting managers and who would do the due diligence visits has not been discussed.

The Secretary stated that there will be some more discussions about how to transition into working with NEPC. In order to invest in Alternative Investments decisions need to be made timely or the Plan will miss out on time-limited opportunities.

The Committee recommended that the Board adopt the Commitment Schedule with an 8% Target Allocation.

Motion/second/approved. (3-0)

6. Discussion and action on the Plan's Current Investment Manager Critique by NEPC.

Mr. Martin suggested that NEPC initiate searches for Small Cap Growth, and the former TCW and Globalt portfolios. Currently the assets from TCW and Globalt are managed by State Street Global Markets and are ready to be transferred when a new manager is hired. While NEPC is not comfortable with Provident, it would save on transition costs to leave the portfolio with them until the search is completed.

At this time, WAMCO is not performing well as their portfolio is too heavily invested in mortgages. NEPC would recommend waiting until the market stabilizes before making a decision on this manager.

The Committee approved having NEPC initiate a search for a Small Cap Value and Small Cap Growth managers.

Motion/second/approved. (3-0)

7. Discussion and action regarding NEPC's Credit Strategies Recommendation.

Mr. Martin explained that NEPC would be scheduling Trustee education on the subject of Credit Strategies in the near future.

8. Discussion, development, and approval of the 2008-09 Work Plan.

Vice-Chair Heredia suggested that since the Investment Committee is so busy with all the new investments and education, visiting managers that are performing well is not necessary and should be removed from the 2008-09 Work Plan.

The Committee recommended that the Board approve the 2008-09 Work Plan with the removal of the due diligence reviews for managers that are performing well.

Motion/second/approved. (3-0)

INFORMATIONAL ITEMS

9. Portfolio Transition Recap: TCW to State Street Global Markets (Small Cap Value).

10. Update on Investment Managers on Probation & Watchlist – March 2008

<u>Probation List</u> Provident	Underperformed benchmark, the Russell 2000 Growth Index + 200 bps for the month, YTD and rolling one-year. Underperformed the index, net of fees, for the month, YTD and rolling one-year. Next Step: Continue on the Watchlist pending NEPC review.
Boston Company	Outperformed benchmark, the MSCI Emerging Markets Index + 200 bps for the month and YTD but underperformed rolling one-year. Outperformed the index, net of fees, for the month and YTD but underperformed rolling one-year. Next Step: Continue on probation pending NEPC review.
Seix Investment Advisors	Underperformed benchmark, the Lehman Aggregate + 50 bps, for the month, YTD and rolling one-year. Underperformed the index, net of fees, for the month, YTD and rolling one-year. Next Step: Continue on Probation pending NEPC review.
Alliance	Underperformed benchmark, the MSCI Emerging Markets Index + 200 bps for the month, YTD and rolling one year. Outperformed the index, net of fees, YTD but underperformed for the month and rolling one-year. Next Step: Continue on Probation pending NEPC review.

11. Firm Update:

- **INTECH: Departure of Dr. Cary Maguire, Co-CIO.**
- **WAMCO: Leave of Absence taken by Kenneth Leech, CIO.**

Motion to accept all Informational Items.

Motion/second/approved. (3-0)

Approved:



**RUSSELL U. CROSBY, SECRETARY
BOARD OF ADMINISTRATION**