CITY OF PONTIAC, MICHIGAN
GENERAL EMPLOYEES RETIREMETN SYSTEM
BOARD OF TRUSTEES
SPECIAL MEETING
AUGUST 24, 2010

A special meeting of the Board of Trustees was held on Tuesday, August 24, 2010 at the Marriott Hotel at Centerpoint Parkway, Pontiac, Michigan. The meeting was called to order at 9:12 a.m.

TRUSTEES PRESENT
Shirley Barnett
Koné Bowman
Charlie Harrison, Chairman
Mayor, Leon Jukowski
Patrice Waterman
Debra Woods
Andrea Wright

TRUSTEES ABSENT
Devin Scott *(absent)*
Kevin Williams *(excused)*

OTHERS PRESENT
Chris Kuhn, Gray & Company
Cynthia Billings, Sullivan, Ward, Asher & Patton
Ellen Zimmermann, Retirement Administrator
Jane Arndt, M-Administrative Assistant
Brian Holland, Artio Global Investors
Rebecca Kubick, Artio Global Investors
Marquette Chester, Invesco
Lauren O'Bryan, Invesco
Talmadge Gunn, Ambassador Capital
Pamela Hopkins, Munder Capital
Andrea Leistra, Munder Capital
Michael Vandenbossche, Munder Capital
Michael Barrett, Mesirow Financial
Tracey Savage, Mesirow Financial
David Desmond, Peritus Asset Mgmt.
Tim Gramatovich, Peritus Asset Mgmt.
Ron Heller, Peritus Asset Mgmt.

Gray & Company – Second Quarter 2010 Performance Review
Mr. Kuhn said that the quarterly performance report normally contains a write up on what happened in the market during the period: this report contains more of an educational piece.

He described VIX (Volatility Index) which was created in 1993 to measure the implied volatility of the equity market. The VIX demonstrates a negative correlation to the S&P 500. When the S&P is down the VIX is up. This can be used as a portfolio management tool, however, it is not viable if used on a monthly basis. The index is a good tool to manage hedge funds on a daily basis. It can also be as a personal portfolio management tool. As the VIX climbs investors can lower their equity allocations.

Inflation is flat and there is fear of deflation. The Fed continues to be on hold with interest rates effectively at zero. They are trying to see sustained economic growth before raising rates. A rally in fixed income during the second quarter pushed yields further down. There has been a lot of "risk on / risk off" trading since the sell off in 2008. When the market is up investors buy risk but when the market declines they flip the switch and move to safety. This has been an indiscriminate market going in and out of favor.

Chairman Harrison asked whether high yield is in extra innings and if it has out lasted its time frame. He questioned the returns at 400 basis points over the treasury index at 800 basis points. He also asked if they are still finding companies to buy. He did not feel that the returns fit the forecast.

Mr. Kuhn indicated that there was a lot of red ink in the equity market during the second quarter after three to four good quarters. There was a correction to the market during the second quarter.

Trustee Bowman asked if Lehman is still part of Citibank. Mr. Kuhn stated that the Lehman assets were all sold off and a portion was bought by J.P. Morgan.

Mr. Kuhn said that fixed income was strong due to a stalled global economy and with the government stimulus coming to an end. The government had done its best to improve liquidity and repair the banking industry.

Trustee Waterman left at 9:21 a.m.

The appreciation in fixed income securities reduced the yield to maturity. The Barclays Capital U.S. Aggregate Index dropped to a record low level of 2.8% in June. Total bond returns in fixed income for the quarter saw the Barclays Aggregate at 3.49%; Barclays Credit at 3.27%; Barclays Mortgage at 2.87% and Barclays Long Government at 11.48%. Interest rates for long-term bonds (twenty to thirty years) are down.

Trustee Waterman returned at 9:23 a.m.

Yield is being produced by bond interest. There has been some appreciation. The yield has been the biggest part of the return. It will be going away over the next five years.

He explained how high yield works in correlation with the credit spreads. Credit spreads were 57 basis points in Aaa at the end of the first quarter and 80 basis points at the end of the second quarter indicating an increase in yield of 23 basis points for those securities. B-rated securities produced more than a 10% yield and has reset back to the sixth or seventh inning. High yield is one of the best investment areas with lots of opportunities; all bonds, regardless if they are good or bad, have been moving in the same direction.

Chairman Harrison asked when the run in high yield will be over questioning whether it will be at the end of the year. Mr. Kuhn said he does not know how long high yield will be in favor, however, it is currently producing more income than Aaa securities. Core fixed income will be challenged to produce 5% returns in the next three years.

The international equity market saw downturns similar to the U.S. equity markets. The dollar continued to appreciate which is not good for U.S. investors. Returns for international fixed income rallied during the second quarter.

Chairman Harrison asked about commodity returns and investments. Mr. Kuhn said that there are a lot of hedge funds with commodities. Gold can be a long-term holding yet it poses the difficult question as to who would make the decision to exit. It is hard to say whether gold is over or under valued. Normally when you see a lot of ads for gold on television, it is at the end of its cycle.

Chairman Harrison asked about a commodities basket. Mr. Kuhn said he would favor active management for commodities because the different pieces do not behave the same way. Oil can be up and gold can be down. A trader can invest long or short commodities, using their insight in the market and sophisticated algorithms. It makes more sense than buying a basket of commodities.

The Fund saw a lot of red ink during the second quarter down 6.5% behind the policy index at -6.34%. Total plan numbers year-to date were -1.84% versus the policy index at -2.05%; one-year at 15.49% versus 14.97%; five-year at 3.15% versus 2.63% and ten-year at 3.95% versus 3.56%.

None of the managers stood-out positively or negatively during the quarter.

Munder had a good quarter as the market declined.

Kennedy has also done well versus the benchmark.

Ms. Billings asked about the ten year numbers and whether the System needs to be concerned that they are below the actuarial assumption of 7.5%.

Mr. Kuhn said that there is no way for the Fund to receive those type of returns based on the market. You must look at a thirty-year horizon.

Ms. Billings asked if the assumed rate of return should be adjusted. Mr. Kuhn said that they do not have enough evidence to change. It is very rare for the equity market to have zero returns over a 10-year period. The twenty year number is 7%. He suggested that the historical numbers will be good; however, he is not sure if the twenty year period will be good enough.

Allianz has transitioned to Ambassador. He stated that Nicholas Applegate had been overseeing the portfolio since Allianz closed their fixed income product.

He told the Board that the Fund's performance is in the top third of the public funds universe at the 35th percentile. The numbers are good since the Fund is limited by Public Act 314. The Fund's ten year numbers are in the 22nd percentile making them very competitive.

Meeting Break at 9:41 a.m.
Meeting Resumed at 9:51 a.m.

Economic Overview/Markets Roundtable
Chairman Harrison welcomed the managers and began the introductions.

Mr. Kuhn explained the meeting format and said that the roundtable discussion will encompass economic issues and what is going on in the market. With a mixture of managers there will be varying viewpoints.

The Fed recently revised their growth estimates and there has been talk about a double dip recession; do you think there is a high probability?

Michael Vandenbossche from Munder Capital said that he feels there is a 20% chance of a double dip recession. They are still seeing some signs of growth at lower levels. He thinks there will be more intervention.

Tal Gunn from Ambassador Capital contends the economy is in an L-shaped recovery. They have 70 to 80 positions in the portfolio now. There were no inventories and now they are slowly being increased but most companies are down 20% to 40%. Bob Doll from PIMCO believes the economy will be on hold for a long time. The concept of a recovery is difficult since five-year return numbers are under 14 basis points.

Mr. Vandenbossche said they are seeing a slight increase in sales versus being down 20-40%.

Mr. Kuhn asked what the managers feel is a center point for growth.

Mr. Vandenbossche said he believes that 3% growth is too high. With revenues cut back on the equity side they anticipate slow growth.

Brian Holland from Artio Global Management said he anticipates global growth of 3% and 1% to 2% growth in developed markets. Emerging market growth will be moderate with U.S. industry seeing growth from the emerging markets that are unleveraged.

Chairman Harrison asked the affect of the housing numbers due out today and they are not anticipated to be good. What will the effect be?

Mr. Kuhn asked if there will be any positive news.

Tim Gramatovich from Peritus Asset Management said that financial institutions have been lucrative over the last year. Banks are not lending any money – they have a good spread so they will be in good shape. As to real estate, builders are issuers of high yield – sales are down 30-40%. Banks own the properties; they are rebuilding their balance sheets. They will put the real estate back on the market. Builders are aggressively buying at the small end of the market in California.

California has been in a down market. Builders in high yield issues are down 30% to 45%. They have an up close and personal relationship with a lot of the banks that have owned a lot of properties since the decline and they are starting to put a lot of their inventory back on the market and take the losses. Builders are standing down and reducing their inventories. Buyers are aggressively looking at properties at $250,000.00 to $300,000.00 with 4% thirty year mortgages but you need a job to get a mortgage. There are a few signs of growth.

The good news is that things continue to move sideways. A lot of stimulus money kept things moving, but it won't move us out of this and there is nothing on the horizon. Consumers need to come back because they drive the economy. People need to be gainfully employed and not just regionally.

Marquette Chester from Invesco said that he does not believe there will be a double dip recession. The economy has hit the bottom and is rolling along. It is more important than ever to know where to put your money. Things will never go back to what they were. The good news is that financials have been flushed out. There are a lot of viewpoints. Financials are there.

Residential housing will see a drop of 10% to 15% before it finds a floor. A lot of commercial loans have been "extending and pretending"; several trillion dollars of commercial loans are coming due in the next few years, especially office. He expects less leverage going forward.
There are a lot of challenges in commercial real estate and in valuations in "sand states" like Florida, California, Nevada and Arizona. There is a lot of leverage with no earnings. You need to build your portfolio on less leverage versus more. There are opportunities out there but you have to be careful.

Chairman Harrison asked where growth will be coming if you take the stimulus money and census jobs out of the equation. Are savvy investors putting their money in cash or what are they waiting on? Where will growth be coming from?

Mr. Chester said you will not see a lot of wholesale moves in and out of the marketplace. Most investors will stay on the sidelines over the next decade. They are less likely to come in for returns and are looking to preserve capital which is in their best interest. This is the hardest time in history to determine where to go. Cash on the sidelines is earning zero. The tricks used to create wholesale moves are not working. There is no cataclysmic event: we have a decade of hard work ahead.

Michael Barrett from Mesirow Financial said that from a private equity market standpoint there is $450 billion on the sidelines and investors will take baby steps investing. He feels there is a 15% to 20% chance of a double dip recession. There has been a small movement in private equity. They are seeing banks come back and lending in a small way and capital calls are increasing.

It all speaks to liquidity; equity returns will be lower but there will be fewer failures. Going forward there will be rational levels of equity and less debt. Institutional investors will fuel the recovery going forward investing in companies with strong balance sheets with more equity (and less debt). There are more IPO's and they are real companies that institutional investors will see. The economy will continue to move at a snail's pace.

Ron Heller from Peritus Asset Management said that there are a lot of big cash flows and liquidity out there.

Mr. Gramatovich said that he agrees with Mr. Chester. There has been a switch from cyclical to secular. There is a massive amount of cash on the balance sheets (approximately $1.8 trillion) but what you do not see is the amount of debt against those balance sheets. Companies had zero cash and relied on revolving lines of credit – no more. The banks were not there; this is a secular change.

Mr. Vandenbossche said they have seen a lot of cash from money market investments flow into fixed income. As investors take more risk it creates positive steps for fixed income. Investors will move into equities and long-term securities in a lower rate environment. Businesses are not willing to invest with all the uncertainty out there with regard to various legislation including healthcare. He is not sure what effect it will have at the state and local level. Businesses will spend before consumers. Businesses must invest to get us out.

Mr. Holland felt the U.S. consumers will be out for the next few years. It will not be a painless procedure getting back and it will continue for several years. There was excess debt, from the sovereign level to the household level. Consumers in emerging markets will fuel global growth and there will be a global rebalancing. Deleverage will continue for the next few years. Investors will have to drive this, but they are cautious. Growth will be slow.

The zero interest rate environment is distorted. We are seeing changes in investment behavior. Investors will have to drive the economy but many are gun shy. He explained that Nestle is trading in the double digits but have been punished for being domiciled in Switzerland. He feels the equity markets will continue to be strained.

Mr. Kuhn asked if the low growth rates, low interest rates and weak consumer consumption in the United States looks like Japan.

Mr. Holland said that the "Japanification" of Europe is more likely than the U.S. The U.S. is more entrepreneurial. They are focusing on companies in Europe with global investments.

Mr. Vandenbossche said that this is not the same as what was experienced in Japan. The Fed was quick to take control to insure the stability of U.S. banks; Japan took 2 and a half to three years to get there. The zombie banks did most of the lending in Japan: 100% of consumer debt and 80% of corporate debt. Corporate debt in the U.S. is 40% to 45% : there is another source available here. We had a steep yield curve; Japan had a flat yield curve.Banks in the U.S. were recapitalized quickly. Geithner and Bernanke acted quickly. They will not raise rates until there are sure signs of recovery.

Mr. Chester said that at 10:15 a.m. it was announced that sales of previously occupied homes plunged 27% in July which is the lowest level since 1995. Mortgage rates are at record lows but consumers are concerned about their jobs and the economy. This is at the base of consumer decisions. There is no quick fix. Property values were too high and have reset. Consumers cannot use their homes as an ATM any more. This will take time – people will have to work and save.

In Nevada, 70% of mortgages are under water. A person in Nevada could have never missed a mortgage payment but because so many homes have foreclosed in his area he is now underwater. There is talk of extending a thirty year overvalued mortgage to fifty years. That system is not going to work. We need to forgive and reset mortgages.

Mr. Kuhn asked if the trustees had any questions.

Chairman Harrison told the private equity managers they were welcome to sit in on the fixed income presentations.

Meeting break at 10:34 a.m.
Trustee Jukowski left at 10:34 a.m.
Meeting resumed at 10:51 a.m.

<u>Munder Capital – Core Fixed Income</u>
Ms. Britton said that this System has been a valued customer since the 1980's and she has many friends here. There have been no manager or firm changes. The fixed income team has thirteen members: they have added a junior portfolio manager and two analysts. She introduced Mr. Vandenbossche, a senior portfolio manager on the team specializing in corporate and mortgage backed securities.

She introduced Andrea Leistra to the Board. When she retires at the end of the year, Ms. Leistra will take over the client service relationship. When she announced her retirement she could not have picked a better person to replace her. Ms. Leistra possesses all the qualities to do a great job. She has been with Munder for fifteen years and has twenty-two years investment experience.

Ms. Leistra told the Board that it is a pleasure being at the meeting. She started her career in the not for profit area and endowments. She is looking forward to getting to know everyone better. The City of Pontiac is an important relationship to them.

Mr. Vandenbossche said that treasuries were the best performers during the second quarter at 4.68%. There was a flight to quality due to economic concerns in Europe. They were underweight treasuries. They were overweight in AA, A, and BBB-rated securities with decent returns. He reviewed other areas of annual out performance. Agency mortgages returned 7.47%; commercial mortgages 30.51%; asset-backed securities at 12.9% with treasuries at 6.67%. They were overweight to many of those areas. It was no surprise that high yield returned 26.77% for the twelve month period.

He reviewed their performance for the quarter at 2.91% versus the benchmark at 3.49%; year-to-date at 4.92% versus 5.33% and one-year returns at 10.07% versus 9.50%. These returns are no surprise based on Mr. Kuhn's commentary.

He reviewed the portfolio characteristics. Their performance versus the benchmark was due to an underweight to treasuries versus the benchmark. Commercial mortgage-backed securities and asset-backed securities should be favored in this market. There are a lot of senior structured securities and real estate valuations that have dropped much lower than during the peak of the third quarter of 2007 but are still not below the 1999 and 2000 levels. It is safer to have exposure in treasuries versus real estate.

Over the last twelve months the rating agencies have downgraded 4,500 issues. They did not have any of these downgrades in their portfolio.

Corporates have become a shrinking piece of the index. The treasury composition of the index has grown from 25% to 32% and corporates have decreased from 23% to 21%. Less supply and more demand bodes well for them. Their allocation to asset-backed securities and commercial mortgage-backed securities should bode well for yield in the portfolio. They have seen significant cash flow from money market and bonds.

They are a duration neutral manager but they look at interest rate inflation in order to determine whether to overweight short-term or long-term treasuries. This will allow the portfolio to generate positive returns when the yield curve flattens out. Their strategy has not changed.

Chairman Harrison asked what their projections are going forward for the next twelve months. Will they have the same weightings or will they shift sectors in the portfolio.

Mr. Vandenbossche said that changes would be made based on performance in these sectors. They may rotate mortgages into corporates. There is no reason to change unless the market dictates or the yield curve position has changed significantly.

Chairman Harrison asked about returns in a high grade portfolio over the next twelve months. Mr. Vandenbossche said they would be happy with returns of 3.26% but that would not bode well for the equity market.

Trustee Bowman asked if Mr. Vandenbossche would address the $600,000.00 gap in the valuation. Mr. Vandenbossche said that the change in the valuation was based on withdrawals of $5 million and the amount indicated was net of withdrawals. The portfolio returned 10%, which was a strong year in fixed income.

Mr. Kuhn asked if they have positioned the portfolio for flattening does he see long-term rates coming down or short-term going up.

Mr. Vandenbossche said that short-term rates will stay low and long-term rates will be coming down. We will see low to zero rate inflation. The slower the economic growth the less inflation we will see. They expect a return to the mean: spreads around 80 basis points.

Trustee Barnett asked what affect the General Motors IPO will have. Mr. Vandenbossche said that bond holders will own the company. There are $25 par bonds out there they may get treated well when converted to stock. The government will stay involved until they can break even or make money.

<u>Ambassador Capital – Core Fixed Income</u>
Talmadge Gunn stated that he is the new kid on the block. He thanked the Board for their confidence becoming one of the investment managers on the team. He appreciates the opportunity. He indicated that he worked at Munder for a number of years and managed this portfolio when he was there.

There has not been a lot of change since they began managing the portfolio. He echoed the same sentiments as Mr. Vandenbossche. The yield curve will provide the best opportunity for returns. The Fed has telegraphed their intentions telling us that rates will remain low. They are not being paid to take risk.

They have an overweight to high grade corporate names. They are not comfortable with the market weight to commercial mortgage-backed securities in the index and are underweight in these. They have positions in Johnson & Johnson and IBM along with heavy exposure to utilities. Utilities provide the same returns as the other corporate securities and they are not going away. They repay dollar to dollar of their debt. They feel this is a defensive posture. He described fixed income regression back to the mean and how the yield curve is priced out of line and how returns are determined by long and short-term securities based on substantial movement in the yield curve.

Economically, commercial mortgage-backed securities have more opportunities but also have more risk. Financials are still risky. Banks have not fully reckoned with their balance sheets. They will remain defensive while housing inventories work through the system. They are not being paid to take a lot of risk in the bond market. They are looking at returns of 50 basis points over the index.

Chairman Harrison asked since they have the green light will they utilize core plus. Mr. Gunn said that they will not be taking advantage of high yield. They are not being paid to take a lot risk. Companies are improving in quality but there is still default risk. There are more opportunities in emerging markets with more risk reward profiles.

Mr. Kuhn asked about the big investment in an ETF (Exchange Traded Funds) in the portfolio due to the transition, and whether they are planning to move the money out. Mr. Gunn said that 45% to 50% of the portfolio is in a corporate ETF. This allowed them quick exposure to the corporate market. As individual names become available they will sell off the ET. They are also looking to put a percentage into asset-backed securities. As a sector, they are not high on commercial mortgage-backed securities but there are opportunities in some vintage names. They are not looking for exposure greater than the index.

Peritus Asset Management – High Yield
Mr. Desmond said that they do not have the long-term relation of Munder Capital. This is their third manager review meeting. They administer the high yield portfolio for the System.

There have been a couple of personnel changes. A managing director in their structured credit business and a member of their marketing group left to pursue other options but they are not planning to replace them. Their goal is to grow the firm internally through educational means, such as CFA's and PhD's. They are in full compliance with the System's Investment Policy Statement.

Mr. Gramatovich said that they are the "loan sharks" and are not playing defense nor looking to hide. There is risk in high yield but they were the Christmas goose in 2009 beating the index by 3,000 basis points. They are currently a little below the benchmark with some cash in the portfolio to reduce risk.

The market is good for them and absolute yields will be low in this cycle with no pressure in rates going forward. High yield is not sensitive to interest rates. Their expectation is to deliver returns going forward.

Based on this muddling economy they are in a sweet spot. The other managers are talking about limiting risk but they are not concerned with risk or measuring standard deviation or tracking errors. They are lending money to companies that have cash and companies that have stronger balance sheets and during bad times bond holders were treated well. They are paid to avoid default risk.

Spread levels over the last five years are at 1.35%. They are putting money to work at 10% well above spread averages historically. Average median returns are 7% and they are seeing paper well above that mark. The System has charged them with putting that money to work. They are seeing record issuance.

In reality private equity guys perform leverage buyouts of companies leveraging up with bonds and loans having only 30% to 40% in equity. High yield guys buy paper getting higher returns with much less risk than private equity.

He described how buyout guys like Blackstone buy companies and leverage them up to their eyeballs then issue AAA-rated bonds. When this happens there is no protection for the bond holders.

It is important to understand different areas of risk. There is no interest rate risk right now but there is credit risk. The default rate for issuers financing debt will be well below normal in 2011 under 2% and for the next few years.

The coupon income will be there which in high yield could be substantial. The market is telling them that there is no risk for the next couple of years. They are clipping coupons at substantial rates. Capital gains will not be there for the next few years.

They are not a distressed player. The deep discounts are not there because they are being offset by credit. They are looking at 10% returns going forward. Not sure a lot of the other managers can get these returns. There is $1.3 trillion in this market class and not a lot of experienced competition. They are excited about the future.

Trustee Wright left at 11:43 a.m.

Chairman Harrison said that they are seeing things from a different angle. High yield had an excellent run beating up the benchmark. Earlier today there was discussion whether they were at the end of their run. It was determined that they have gone back to the middle of the game. He indicated that balance sheets are looking good but there is still a lot of debt. He asked where the extra growth is coming from.

Mr. Gramatovich said that they are happy with the liquidity they are seeing. He does not know where they are or what inning they are in. He suggested that they quit looking at traits and that high yield is an official asset class that looks at credits. Returns are part of risk taking and they are looking at 8% to 10% returns. He described how they are clipping coupons at 10-3/4% for a company that decommissions nuclear reactors. There are still a lot of attractive issues.

The rating agencies are smoke and mirrors and are packaged inside of the banking industry. That system requires ratings and whether it is AAA or D-rated. The most important issue is getting the money back if there is a default. They recognize that it is all about how they lend money going into a depression.

Micro economics are more important than macro to them. He does not know what inning they are in they just know that this is as little business and balance sheet risk they have ever taken. There is still a lot of good value in the market. It is important to understand that there is a 0.1% yield environment in the money markets which may go on for sometime. It is more likely that we will see spreads compress than blow out.

A 9% yield is impressive and a micro credit cycle is good for companies. A normal market for them is 7% if things stay compressed. There are too many people validating money into this asset class.

<u>Artio Global Investors – International Equity</u>
Rebecca Kubick told the Board that they appreciate the opportunity to attend. There have not been any organizational changes.

The international equity team added two new members during the past few months. Steven Lew is a senior portfolio manager specializing in Asian markets who speaks Mandarin and Danny Seth is a senior research analyst specializing in special projects for senior portfolio managers. Keith Walter left last month taking his expertise in global equity and pharmaceuticals to one of their clients.

Trustee Wright returned at 11:50 a.m.

Mr. Holland said that index returns were negative across the board. Europe clearly lagged in the first two quarters due to sovereign debt issues. There is a long-term view now; last year there was a lot of policy intervention by governments.

There are still a lot of bank issues so they have nothing in European banks. There was a significant rally when the government bailed out banks with bond holders getting zero. The bailouts in Europe were different than in the United States. The stress test was a joke in Europe. In the U.S. banks were forced to raise capital. European Banks have two to three times the leverage of U.S. Banks. Global banking requirements have been pushed out to 2013. Deutsche Bank is the most leveraged bank. They have taken a different position, investing in high quality emerging market companies with no government debt.

Their regional positions are in larger high quality companies across regions and sectors. As of June 30, 2010 they are overweight to emerging markets, having extended their exposure to drive performance. They are doing more bottom-up analysis with the new analysts.

He reviewed their regional weightings. They are underweight to Latin American, Central Europe and Eastern Europe with an over exposure to the Russian equity market. They are underweight to Brazil like most international managers. The Russian equity market is undervalued by approximately 40% and they expect events to release value in the next six years.

They utilize a bottom up process which has led to a lot of European names due to their steep discounts. They are looking at consumer staple names like Nestle and Dannon with a three to five year time horizon in this slow growth environment. Debt is moving from the private sector to the public sector.

He reviewed their sector weightings indicating that they are overweight to cyclical sectors like materials and consumer staples. There has been a lot of money created by the deflationary pressures in the United State. Bank loans have slowed down and U.S. household savings has increased. With money not moving we will not see inflationary pressure. Inflation occurs when there is more money chasing fewer products. They are taking a barbell approach with two-thirds of their portfolio in a defensive position and one-third in tactical Asian technology names.

He indicated that their bottom up process led them to sell out of big oil names, like British Petroleum, in February before the oil spill because there was less relative value and growth. Sometimes it is better to be lucky than smart. They added smaller more nimble names like Dragon Energy Partners which lowered their sector weighting to energy. They added a lot of names at fire sale prices such as Nestle and Dannon. These have a three to five year horizon.

Chairman Harrison explained that the Board gave them the ability to increase their emerging market exposure. Mr. Holland said that their exposure to emerging markets is 35% in an unconstrained portfolio. They are seeing most of the growth coming from the emerging markets and will not reduce their exposure anytime soon. Most portfolios have exposure around 32%.

They are overweight to materials and consumer staples. In the near term there are deflationary pressures. Transactions have slowed and money has stopped. There is a need for confidence to increase along with jobs. Over the long term there could be inflationary pressure. Overall two thirds of the portfolio is defensive (long term) and one third is tactical (3 to 5 years).

Trustee Bowman asked about their positions in mining companies. Mr. Holland said that they have positions in gold mines in Canada and Russia.

Copper and silver spans both industrial and precious metals. They have shifted their interest to gold at a 50%/50% split. The valuations are not stretched. They do not expect any changes unless the interest from China falls off the cliff.

Trustee Barnett asked about their investments in airports. Mr. Holland said that airports make a lot of money. These are not like investing in airlines. Airports do not carry a lot of debt. They make their money when people are waiting for planes. They bought into Fraport the Frankfurt, Germany airport. It was priced as a utility around fourteen times the cash flow. Even with the economic collapse they saw a decrease in the price of these companies when they bought them.

Meeting Break at 12:08 p.m.
Meeting Resumed at 1:04 p.m.

<u>Invesco Private Capital</u>
Mr. Chester said that Lauren O'Bryan has direct responsibility to communicate with the fund of funds clients.

He provided an update of the firm. Their only business is managing money for their clients. They are not into the banking or the brokerage business. They have on-the-ground research in twenty different countries. They currently have $580 billion in assets under management.

They recently closed on the acquisition of $190 billion investment management assets of Morgan Stanley's VanCampen. This was an addition to their product line they did not previously have. There have not been any changes to their capital structure. They are publicly traded with a $5 billion to $9 billion capitalization and are a significant asset management player.

They offer both a private equity commingled fund of funds product and the William L. Ross distressed private equity fund is included in the fund of funds. They have a proven track record of successful investing through multiple market cycles. Their strategy is to build their portfolio around core brand name funds including venture capital, mezzanine and buyout partnerships. They have had $4 billion committed to more than 450 partnerships since 1982.

They have a highly experienced team. Principal, Evan Darr recently left to pursue his MBA at Oxford and will return in 18 months. General Partner, Mary Kelly has cutback her hours at the firm and is moving toward retirement. She has twenty-five years of experience in private capital. A senior person will be stepping in during this transition. Theresa Boyd recently returned from working at Lintas for approximately three years bringing back an Oxford MBA to the firm.

They have consistently applied their strategy. The portfolio was developed across strategies and is well diversified by vintage years. It was built around in-depth due diligence with established brand name funds. They are on track with this investment. It is more important than ever to be cautious; they are highly selective.

Lauren O'Bryan said that Invesco Partnership Fund V has drawn $1,002.456.00 which is 40% of the committed capital of $2.5 million. Management fees paid to date are $47,866.00 with a net asset value of $908,525.00 as of June 30, 2010.

She indicated that last year the J-curve outflows outweighed the returns. Over time the Fund will provide performance and increases in valuations.

The Fund has made three new commitments since the third quarter of 2009. The portfolio is now complete with $124 million in committed capital with eighteen private equity partnerships. Currently, $44 million or 35% of the aggregate commitments have been drawn down. The portfolio is very young with a cost-weighted life of 1.5 years. The Fund's first investment was in 2006 during the vintage years so it is still early in the game but is beginning to receive distributions.

She described three new partnership commitments in Sterling Partners Small Market Growth 2009; Bertram Growth Capital II and Roundtable Healthcare Partners III. Two of the partnerships are in venture capital and one is in buyouts. All are middle market investors.

Sterling Partners has setup a $250 million pool to invest in small to mid market companies. This is their sweet spot and they are big believers in the Sterling Team. Sterling Partners has a long track record, founded in 1983. They are returning to their roots, investing in for-profit education services companies valued at less than $75 million. Their performance from 1996 to 2007 was over four times cost.

Bertram Capital is a $500 million fund with a primary focus on developing a portfolio of six to eight lower middle market business platforms in industrial, manufacturing, business services and health care. They will attempt to transform those core platforms into market leading firms by improving management, revising sales strategies, enhancing operations and identifying strategic acquisitions. They look for market inefficiencies.

Roundtable Healthcare Partners $600 million fund is looking to make investments in mid-market healthcare companies. Their team has extensive strategic and operational experience from senior positions at Cardinal Health and Allegiance Corporation. Their first fund's returns were in the high double digits. It is too early to judge returns for this fund. The aging population and government desire to increase coverage are factors in their favor.

She described the investment focus and diversification of Fund V. Last year she told the Board about Spark Capital a venture capital firm who was one of the first investors in Twitter which is a social networking site. They are currently investing in online college enrollment technology.

International partnership Target Partners has invested in companies that supply mobile social gaming software platforms that can turn single-user games into multi-user. They have invested in a company that has an enhanced mobile device management platform offering virtual goods and services through DROID. Another company Joulex has developed green energy management software to reduce power consumption of IT networks. Their pilot project resulted in energy savings of 30%.

Pine Brook Road Partners, LLC is a leverage buyout financial firm that has invested in early stage oil and gas drilling in the Rocky Mountains and the Pacific Northwest.

Chairman Harrison asked where the System is on the J-curve. Ms. O'Bryan said that it is still on the downward side at 35% invested. Within the next three years it should start on the up side and the System should begin to see returns.

Mr. Chester informed the Board that April Simon has moved on to Washington, D.C. to start a family. She was married in May. Chairman Harrison said that April's past service to the Board is appreciated.

Mesirow Financial Private Equity

Ms. Savage thanked the Board for their business and appreciates their support.

Mr. Barnett said that he is the Managing Director and joined Mesirow in 1984 on the direct investment side and on business development.

Mesirow is an independent and employee-owned financial services firm with no institutional ownership. In 2001 they became 100% employee-owned with 270 owners.

They experienced a highly profitable year in 2009 with $525 million in revenues including $300 million in shareholder capital. They have virtually no debt.

The growth and profit of the firm is driven by alternative investments. They have $40 billion in assets under management firm wide with approximately $3 billion in private equity driven by fund of funds with moderate sized platforms.

They have a deeply experienced team with extensive knowledge gained through partnerships and direct co-investments. They have built relationships giving them access to premier private equity managers and unique direct/co-investment deal flows. They are invested in approximately 125 private equity partnerships.

There are no conflicts of interest or separately managed accounts. They align their interests with their clients by co-investing with them. Their compensation comes from the private equity fund of fund investments.

He provided an overview of the private equity management team. Chairman and CEO Jim Tyree has been with Mesirow for over twenty years. From a business perspective, their marketing sales and research departments are young.

He told the board that Paul Rice built the first portfolio in this asset class for Mesirow. He plans to work for another year and a half.

They get three-year commitments for from new hires in private equity. They sponsored these employees for nighttime MBA programs. There has been no employee turnover.

They feel it is all about the client service and believe that you build the business through sales and marketing.

He reviewed their representative clients list. They have seventy-five active Limited Partners. Approximately 52% of their capital comes from public pension funds. They are aware of their fiduciary responsibility. Their compliance is strong.

He described their investment strategy. It is a $910 million fund which is well diversified and similar to the Invesco portfolio. Capital committed over the three to four vintage years has been nicely diversified with 15% to 25% in special situations, 20% to 25% in non-U.S. buyout; 35% to 40% in U.S. buyout and venture at 22%. Primary investments comprise 80-90% and secondary investments 10-20%. These are top tier private equity managers.

The Fund's investments are in mezzanine with an industrial focus, distressed equity funds where they fix and grow businesses and sell to larger businesses. Not all investments are early stage start-ups; the portfolio is balanced. There are currently forty managers in the portfolio which is almost fully committed. They only invest in top-tier private equity funds.

The investment pace has been slow. They are seeing a pickup in capital calls which started in earnest in 2007. To date only 38% or $1.875 million of the System's $5 million commitment has been drawn. Going forward they are looking at quarterly capital calls of 3% to 5% and 5-6% in 2011. They are on target to the sub asset classes. It is never good when a private equity firm goes public.

In the J-curve they are looking to break even in seven to eight quarters. The Fund is 35% invested but the valuations are down. There are a lot fewer players in private equity. They are attracting new technology and are well positioned going forward. They will add five to six managers. They are bullish on the portfolio. The return expectation is 400-600 basis points over the S & P.

Chairman Harrison asked if the venture capital side is where they see the most promise. Mr. Barrett said that returns have been flat the last seven years in venture capital. They look at contraction in funds. A lot of these organizations were built to last. In the late 1990's there were 900 venture capital firms now there are 90. The market has returned to reality. They have holdings in multiple stage venture capital funds. As the environment gets better, they will see real jumps in the asset class. Venture capital firm Accel X invested in the early stages of Facebook.

Chairman Harrison asked if Mr. Barrett thinks the market will be more volatile closer to the election. Mr. Barrett said he is not a public equity guy. The most important thing is that the banks are coming back to the market.

Mr. Chester said that the elections will not have much of an effect. The same opportunities will be recognized before the election but will be waiting until after the election. It will not have much of an effect on the capital markets.

Mr. Kuhn said that many feel that if the Republicans control one side and the Democrats the other is the best scenario. Having a deadlock and knowing nothing will happen will be better for the markets.

Mr. Chester said he disagrees with that scenario. Not since the 2000 bubble have managers had to work this hard to recognize good companies.

The managers left at 2:00 p.m.

<u>Meeting Wrap-Up / Nexos Discussion</u>
Mr. Kuhn told the Board that Larry Gray was at Nexos last week.

Trustee Barnett said that the manager has been evasive.

Mr. Kuhn said that they have been disappointed with the level of service and report detail. Nexos is not planning to continue raising new funds. The investment professions are winding down the activities at the fund with one individual overseeing the investment in Super S, a Hispanic grocery store chain. They were beginning to raise capital when the market began its collapse and were never able to reach critical mass.

Chairman Harrison said that they placed most of their emphasis on super market chains. Will they be keeping an eye on the chain and report how it is doing. He asked since this is a private investment will there be an appraisal.

Mr. Kuhn said that Nexos owns 30% of the super market chain. They were looking to improve the internal systems and improve the facilities then sell the asset. They are still looking for a second investor.

The Board will get all the information and answers from Larry Gray. At this point Nexos is looking at closing the door on raising funds.

Trustee Woods said that the System still needs to know how the investment is doing.

Trustee Barnett asked if there has been an audit of this investment.

Ms. Zimmermann said that they asked for the audit in June and they said it would be available in July. They received information but it looked a lot like what they received in the past from Onyx and CAPROC.

RESOLUTION 10-077 By Barnett, Supported by Waterman
Resolved, That the meeting be adjourned at 2:10 p.m.

Yeas: 7 – Nays: 0

As recorded by Jane Arndt