Minutes
Investment Advisory Council
November 18, 2014

The Investment Advisory Council (IAC) met at 12:00 P.M. Tuesday, November 18, 2014 in the Board Room – First Floor, 60 Empire Drive, St. Paul, Minnesota.

MEMBERS PRESENT: Denise Anderson, Jeff Bailey, Dave Bergstrom, John Bohan, Kerry Brick, Doug Gorence, Laurie Hacking, Kristin Hanson (for Jim Schowalter), Jay Kiedrowski, Gary Martin, Malcolm McDonald, Mary Vanek, and Elaine Voss.

MEMBERS ABSENT: Dennis Duerst and Kim Faust.

SBI STAFF: Mansco Perry, LeaAnn Stagg, Patricia Ammann, Tammy Brusehaver, Stephanie Gleeson, Inma Conde Goldman, Aaron Griga, Ryan Hill, Andrew Krech, Steve Kuettel, Cassandra Boll, Mike Menssen, Charlene Olson, and Melissa Mader.

OTHERS ATTENDING: Ann Posey and Rod Bare, Callan Associates Inc.; Bert Black, Celeste Grant, Christie Eller, Emily Johnson Piper, and Cumah Blake, Office of the Governor; Don Leathers and John Fisher, REAM; Jay Stoffel, Teachers Retirement Association; Zachary Yzermans, Carmen Marg-Patton, and Natalie Mehlhorn, Office of the Legislative Auditor; Edgar Hernandez, SEIU; David Smith, Minnesota Break the Bonds; and Gordon Voss, private citizen.

The minutes of the August 19, 2014 meeting were approved.

Executive Director's Report
Mr. Perry referred members to Tab A of the meeting materials. He reported that the Combined Funds had outperformed its Composite Index over the ten year period ending September 30, 2014 (Combined Funds 8.3% vs. Composite 8.0%) and had provided a real rate of return of 6.5% above inflation over the latest 20 year period (Combined Funds 8.9% vs. CPI 2.4%).

Mr. Perry said that assets decreased slightly over the quarter (Combined Funds ending value of $58.9 versus a beginning value of $59.5 billion), primarily due to net withdrawals, but a small decrease in investment return also affected ending market value. He said that the asset allocation was on target and he stated that the Combined Funds returns were slightly below benchmark for the quarter (Combined Funds -0.1% vs. Composite 0.0%), but above benchmark for the year (Combined Funds 12.7% vs. Composite 12.5%) as well as all succeeding time periods.

Mr. Perry reported that the domestic stock manager group performed in-line with its target for the quarter (Domestic Stocks 0.0% vs. Domestic Equity Asset Class Target 0.0%), slightly underperformed for the year (Domestic Stocks 17.6% vs. Domestic Equity Asset Class Target 17.8%), and outperformed in longer time periods. He said the international stock manager group underperformed its target for the quarter (International Stocks -5.4% vs. International Equity Asset Class Target -5.3%) and for the year (International Stocks 4.7% vs. International Equity Asset Class Target 4.8%), but outperformed in longer time periods. Mr. Perry stated that the bond segment performed in-line with its target for the quarter (Bonds 0.2% vs. Fixed Income Asset Class Target 0.2%) and outperformed its target in all other time periods. He stated that the alternative investments continued to be a strong contributor to performance (5.8% for the quarter and 23.2% for the year). He concluded his report noting that, as of September 30, 2014, the SBI was responsible for managing close to $80 billion of assets.

Mr. Perry referred members to Tab B of the meeting materials for an update on the budget and travel for the quarter. He stated that the SBI was currently below budget. Next, he noted the FY14 Legislative Auditor report was being completed by year end and would be distributed to IAC members as soon as it is available. He also mentioned that a draft copy of the FY14 annual report would be distributed in December to Board and IAC members for review. The final version was expected to be published in January. Mr. Perry stated that the Sudan and Iran legislative updates were provided.

Mr. Perry provided an update on the Minnesota 529 College Savings Plan, stating that Morningstar had raised the rating for the State's 529 Plan from negative to neutral. He reminded everyone that, due to the lack of a state tax incentive, further rating increases should not be expected.

Next, Mr. Perry provided an update on the Duluth Teachers Retirement Fund Association (DTRFA) assets. He reported that the Duluth Teachers membership had voted in favor of the merger and the SBI and Duluth had been working to transfer their assets to the SBI. The DTRFA assets will be invested in the SBI Combined Funds allocation but accounted for in a separate account until the merger with the Teacher's Retirement Assets (TRA) takes place as of July 1, 2015.

Mr. Perry informed Board members that, going forward, Staff will streamline and improve the manager reports. The goal is to focus on longer term performance and summary manager information. IAC members were reminded they are welcome to contact SBI staff should they desire to read additional manager commentary or to request a Private Placement Memorandum for an Alternative Investment manager.

Mr. Perry asked for an update on the funded status of the pension funds present. Mr. Bergstrom stated that as of June 30th, MSRS was approximately 91.4% funded. Ms. Vanek reported that PERA was roughly 81% funded and Ms. Hacking stated that TRA was slightly higher at 83% funded as of June 30th.

Mr. Perry concluded his administrative report noting that there was currently no litigation involving the SBI.

Mr. Bailey led a brief discussion regarding the quarterly report changes to ensure that all IAC members were comfortable with the proposed changes. Members who wanted to continue receiving specific information were directed to contact staff to receive manager documents.

Mr. Perry introduced Mr. Hill and Mr. Krech, members of the SBI Alternative Investment team, to discuss the six alternative investment recommendations. Mr. Hill and Mr. Krech described each of the six recommendations in detail to IAC members and answered questions. The six deals were NGP Energy Capital Management (Resource); Sheridan Production Partners (Resource); Welsh, Carson, Anderson & Stowe (Private Equity); Paine & Partners (Private Equity); Oaktree Capital Management (Private Equity); and TCW Direct Lending Group (Yield Oriented). Mr. McDonald moved approval of all six alternative investment recommendations and Ms. Voss seconded the motion. The motion passed.

Mr. Perry introduced the second presentation, Transition Management, which was led by Ms. Brusehaver. Given the topic of transition management was initially brought to the committee in August, Ms. Brusehaver provided an update to the RFI process and recommended that the SBI retain five large and experienced managers to provide transition management services. The managers were BlackRock, Inc., Citigroup Global Markets Inc., Northern Trust Investments, Inc., Russell Implementation Services Inc., and State Street Bank Global Markets. Mr. Kiedrowski moved approval and Ms. Anderson seconded the motion. The motion passed.

Mr. Perry introduced the third presentation, led by Ms. Stagg, which apprised the IAC members of the issue surrounding the internally managed S&P 500 Index portfolio. Given the Dodd–Frank Wall Street Reform and Consumer Protection Act and the resulting impact on the Staff's ability to trade futures contracts, the SBI requested authorization to retain an external manager to manage the Internal Stock Fund if Staff is unable to enter into a new futures trading agreement. Mr. McDonald moved approval and Mr. Bergstrom seconded the motion. The motion passed.

Mr. Perry updated members on the manager retention policy. A paper detailing the policy was included under Tab D.

Mr. Perry introduced Mr. Griga and Ms. Boll to provide an update on Pacific Investment Management Company (PIMCO). Mr. Griga and Ms. Boll discussed staff turnover, organizational changes, the investment process, and the impact on the SBI's separately managed account. While there was no action item regarding PIMCO, the SBI staff will be monitoring the situation closely and will keep the IAC apprised of any developments. In addition, the SBI will develop a list of potential candidates in the event it becomes necessary to replace PIMCO.

The meeting adjourned at 3:04 p.m.

Respectfully submitted,

Mansco Perry III

Mansco Perry III
Executive Director and
Chief Investment Officer