Minutes
Investment Advisory Council
February 17, 2015

The Investment Advisory Council (IAC) met at 12:00 P.M. Tuesday, February 17, 2015 in Room 117, Retirement Systems Building, 60 Empire Drive, St. Paul, Minnesota.

MEMBERS PRESENT:	Jeff Bailey, Dave Bergstrom, John Bohan, Kerry Brick, Dennis Duerst, Dave DeJonge, Kim Faust, Doug Gorence, Laurie Hacking, Kristin Hanson (for Myron Frans), Jay Kiedrowski, Gary Martin, Malcolm McDonald and Elaine Voss.
MEMBERS ABSENT:	Denise Anderson.
SBI STAFF:	Mansco Perry, LeaAnn Stagg, Patricia Ammann, Paul Anderson, Cassandra Boll, Nate Blumenshine, Tammy Brusehaver, Stephanie Gleeson, Inma Conde Goldman, Aaron Griga, Ryan Hill, Andrew Krech, Steve Kuettel, Mike Menssen, Mercy Ndungu, Iryna Shafir, Jonathan Stacy, Robert Weiler, Charlene Olson, and Melissa Mader.
OTHERS ATTENDING:	Ann Posey and Rod Bare, Callan Associates Inc.; Bert Black, Celeste Grant, Christie Eller, and Emily Johnson Piper; Jay Stoffel, Teachers Retirement Association; and Edgar Hernandez, SEIU.

The minutes of the November 18, 2014 meeting were approved.

Executive Director's Report
Mr. Perry referred members to Tab A of the meeting materials, and he reported that the Combined Funds had outperformed its Composite Index over the ten year period ending December 31, 2014 (Combined Funds 7.8% vs. Composite 7.5%) and had provided a real rate of return of 6.7% above inflation over the latest 20 year period (Combined Funds 9.0% vs. CPI 2.3%).

Mr. Perry said that assets increased over the quarter by 1.8% (Combined Funds ending value of $60.0 versus a beginning value of $58.9 billion), due to investment returns outweighing net outflows. He said that the asset allocation, which was slightly overweight domestic stocks and slightly underweight international stocks, was rebalanced back to target in January. The Combined Funds return was twenty basis points (bps) above the benchmark for the quarter (Combined Funds 2.5% vs. Composite 2.3%), but twenty bps below the benchmark for the year (Combined Funds 8.6% vs. Composite 8.8%). The Combined Funds outperformed for longer time periods.

Mr. Perry reported that the domestic stock manager group performed in-line with its target for the quarter (Domestic Equities 5.2% vs. Domestic Equity Asset Class Target 5.2%), slightly underperformed for the year (Domestic Equities 12.3% vs. Domestic Equity Asset Class Target 12.6%), and outperformed in longer time periods. He said the international stock manager group outperformed its target for the quarter (International Equities -3.3% vs. International Equity Asset Class Target -3.9%), underperformed for the year (International Equities -4.0% vs. International Equity Asset Class Target -3.9%), but outperformed over longer time periods. Mr. Perry stated that the bond segment slightly underperformed for the quarter (Fixed Income 1.7% vs. Fixed Income Asset Class Target 1.8%) and outperformed its target in all other time periods. He stated that the alternative investments continue to be a strong contributor to performance (1.1% for the quarter and 18.0% for the year). He concluded his report noting that, as of December 31, 2014, the SBI was responsible for managing more than $80 billion of assets.

Mr. Perry referred members to Tab B of the meeting materials for the administrative report. He reported that fiscal year to date, the SBI was running below budget. Next, he stated that the legislative auditor would issue a letter noting that there were no findings in the audit. Board and IAC members will receive a copy of the audit letter when it becomes available. He then noted that approximately 97% of the Duluth Teachers' Retirement Fund assets had been transferred to the SBI. He expected the remaining assets to be transferred by the end of the fiscal year.

Mr. Perry requested Council support Staff and the Minnesota State Retirement System (MSRS) regarding the addition of target date funds to the Unclassified Plan lineup. Mr. Bergstrom moved approval of the recommendation and Ms. Voss seconded the motion. The motion passed.

Mr. Perry discussed the next action item, which related to the Metropolitan Council's (Met Council) Other Postemployment Benefits (OPEB) plans. The Met Council requested that the SBI manage a customized fixed income portfolio which would more directly match their liabilities with their assets. Met Council would continue to maintain the ability to set their asset allocation. After a brief discussion, Ms. Hacking moved approval of the recommendation and Mr. DeJonge seconded the motion. The motion passed.

Mr. Perry stated that Sudan and Iran holdings updates were provided. Next, Mr. Perry stated there was currently no litigation involving the SBI.

Mr. Perry introduced the newest members of the SBI investment staff: Inma Conde Goldman, Mercy Ndungu, Jonathan Stacy, Robert Weiler, and Nate Blumenshine. He also introduced the newest member of the accounting team: Iryna Shafir. Continuing the theme, Mr. Bergstrom introduced Dave DeJonge, who is the Interim Director at Public Employees Retirement Association (PERA).

Mr. Perry introduced the directors of the retirement plans. Mr. Bergstrom began the retirement plans' presentation by discussing the funded status history of MSRS. As of June 30, 2014, the MSRS General Plan had a funded status of 92.4% based on market value, the Correctional Plan was 78% based on market value, and the State Patrol Plan was back up to 83.4% based on market value. Mr. DeJonge described a few of the plans and funded status overseen by PERA. They administer seven plans, which includes the Minneapolis Employees Retirement Fund (MERF), which was officially merged into the PERA General Plan in January. He noted that the General Plan had improved to 82% funded, the Correctional Plan was 106% funded, and the Police and Fire Plan had improved to 89% funded, all based on market value. Ms. Hacking stated that Teachers Retirement Association (TRA) was 83% funded on a market value basis and also explained the benefit changes that reduced liabilities by $6 billion.

Mr. Bergstrom followed by discussing a couple of legislative initiatives. The first is legislation regarding a self-correcting cost-of-living adjustment (COLA). Currently, the COLA does not self-correct when the funded status decreases. MSRS would like to reduce the COLA to 2%, without having to seek legislation, if the funded status fell below 85% for two years, or if it fell below 80% for one year. Second, MSRS and PERA would like to reduce the investment return assumption from 8.5% to 8%.

Mr. Perry proceeded to a discussion about the Alternatives portfolio. First, he addressed the composition of the portfolio. He pointed out that the SBI is attempting to increase diversification, both in terms of investments and General Partners ("GPs"). He mentioned that "core type" managers (GPs with whom the SBI has a long-standing relationship) will typically receive larger allocations and managers new to the SBI's Alternatives portfolio will receive a smaller allocation. Next, he stated that given the current unallocated capital balance, combined with distributions received from General Partners, mean that the SBI needs to allocate roughly $2.5 billion to GPs each year. Following that, Mr. Perry called attention to Schedule A and the additional data being provided. Next, he discussed the thought process regarding the pacing of alternative asset investments given the unallocated capital balance, target allocations, and distributions received from GPs. He then asked council members to ponder whether the SBI should maintain a short list of pre-approved GPs. The SBI has been prevented from participating in deals in the past because GPs occasionally conduct short fund raising windows that have fallen between IAC meetings. After a brief discussion, Mr. Perry noted that staff will produce a memo at the May or August IAC meeting about pre-approving a roster of managers. Lastly, Mr. Perry introduced the idea of increasing geographic diversification within the Alternatives portfolio.

Mr. Krech and Mr. Hill, members of the SBI Alternative Investment team, were introduced to discuss the six alternative investment recommendations. Before they began, given the price decline for a barrel of oil, Mr. Krech answered questions related to the SBI's Resource managers. Mr. Hill and Mr. Krech then described each of the six recommendations in detail to IAC members and answered questions. The six deals were Blackstone (Real Estate); EnCap Investments (Resource); Oaktree Capital Management (Yield Oriented); Kohlberg Kravis Roberts (Yield Oriented); Avenue Capital Group (Yield Oriented); and MHR Fund Management (Private Equity). A brief discussion followed regarding the sizing of certain allocations. Mr. McDonald moved approval of all six alternative investment recommendations and Mr. Bohan seconded the motion. The motion passed.

Mr. Perry referred members to Tab D where he discussed the streamlined performance sections and Pacific Investment Management Company (PIMCO). The individual VAM pages were replaced with a quarterly economic commentary, noteworthy investment manager comments, and performance data. Regarding PIMCO, Mr. Perry stated that the SBI is retaining them as a fixed income manager. A brief discussion followed regarding the changes made to the book, with Mr. Perry noting the goal is to increase the focus on policy.

The meeting adjourned at 2:45 p.m.

Respectfully submitted,

Mansco Perry TG

Mansco Perry III
Executive Director and
Chief Investment Officer