Minutes
Investment Advisory Council
May 17, 2016

The Investment Advisory Council (IAC) met at 12:00 P.M. on Tuesday, May 17, 2016 in the Board Room – First Floor, 60 Empire Drive, St. Paul, Minnesota.

MEMBERS PRESENT: Denise Anderson, Doug Anderson, Jeff Bailey, Dave Bergstrom, Kerry Brick, Dennis Duerst, Cindy Farrell (for Myron Frans), Susanna Gibbons, Morris Goodwin, Laurie Hacking, Peggy Ingison, Gary Martin, Malcolm McDonald, Carol Peterfeso, and Elaine Voss.

MEMBERS ABSENT: Kim Faust and Shawn Wischmeier.

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

OTHERS ATTENDING: Ann Posey, Rod Bare and Jim Van Heuit, Callan Associates Inc.; Ramona Advani, State Auditor's Office; Bert Black, Secretary of State's Office; Christie Eller and John Mule, Attorney General's Office; Kim Holmes, Office of the Governor; Erin Leonard, MSRS; Jill Schurtz, SPTRFA; Jay Stoffel, TRA; Jim Mulrooney, Wells Fargo; Rick Baert, Pensions and Investments; Edgar Hernandez, SEIU; and Gordon Voss, private citizen.

Mr. Bailey, Chair of the Investment Advisory Council, asked members of the IAC to introduce themselves with their name and affiliation. The newest members to the IAC were: Cindy Farrell, Susanna Gibbons, Morris Goodwin, Peggy Ingison, and Carol Peterfeso.

The minutes of the February 16, 2016 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 March 31, 2016 (Combined Funds 6.3% vs. Composite 6.1%) and had provided a real rate of return of 5.5% above inflation over the latest 20 year period (Combined Funds 7.6% vs. CPI 2.1%).

Mr. Perry said that assets decreased over the quarter (Combined Funds ending value of $57.6 versus a beginning value of $57.8 billion). The Combined Funds return was 70 basis points (bps) below the benchmark for the quarter (Combined Funds 0.5% vs. Composite 1.2%) and 80 bps below for the year (Combined Funds -1.1% vs. Composite -0.3%). The Combined Funds did outperform its target in all other time periods reported.

Mr. Perry reported that the domestic stock manager group underperformed its target for the quarter (Domestic Stocks 0.0% vs. Domestic Equity Asset Class Target 1.0%) and for the year (Domestic Stocks -1.9% vs. Domestic Equity Asset Class Target -0.3%). He said the international stock manager group underperformed its target for the quarter (International Stocks -1.4% vs. International Equity Asset Class Target -0.4%) and outperformed for the year and over longer time periods. Mr. Perry then stated that the bond segment matched its target for the quarter (Bonds 3.0% vs. Fixed Income Asset Class Target 3.0%), underperformed for the year (Bonds 1.9% vs. Fixed Income Asset Class Target 2.0%) but outperformed its target in all other time periods. He stated that the alternative investments had a small lag to performance for the quarter but contributed for the year (total return of -0.4% and 4.2%, respectively). Mr. Perry concluded his report noting that, as of March 31, 2016, the SBI was responsible for managing slightly under $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, Mr. Perry noted that the legislative session was still in session and there were a few bills that had potential impact to the SBI. One bill would require the SBI to report on the feasibility of divesting in fossil fuel companies while another bill had the SBI develop climate change risk management strategies in its investment approach. Staff has been in discussion with Minnesota Management and Budget and the Pollution Control Agency (PCA) on another bill that gives the SBI authority to invest the assets of the Metropolitan Landfill Contingency Action Trust account. PCA would administer this account. Lastly, Mr. Perry noted that the fund directors will update the committee on the status of the funding sustainability measures brought forth by the Minnesota State Retirement System (MSRS) and Teachers' Retirement Association (TRA). There is also language in this bill that would lower the investment return assumption for TRA to 8 percent, which MSRS and PERA did last year.

Mr. Perry stated that Tab B contained the updated information for Sudan and Iran. Mr. Perry noted that there is currently no litigation involving the SBI.

Ms. Hacking, Chair of the Administrative Committee, and Mr. Perry referred members to Tab C of the meeting materials for the Administrative Committee Report. Ms. Hacking noted that a number of request for proposals (RFPs) will go out this year for consultant, custodian, and accounting services. She also noted that, pending approval of the IAC and Board, there is a workplan to implement asset allocation changes to the Combined Fund. Mr. Perry highlighted the two workplans under Development of Investment Policies which include enhanced private equity fee reporting and a review of Environmental, Social and Governance (ESG) issues. Lastly, Mr. Perry asked for the IAC's endorsement of the Proposed Workplan and Budget Plan. Mr. McDonald made a motion to endorse the Proposed Workplan and Budget Plan and Mr. Bergstrom seconded the motion. The motion passed.

Mr. Bergstrom reviewed the recommendations of the Deferred Compensation Review Committee. The Minnesota Deferred Compensation Plan (MNDC Plan) is a joint effort between the SBI and MSRS where the SBI chooses the investment vehicles and MSRS provides administration of the plan. The Deferred Compensation Review Committee reviewed the MN Target Date Funds and recommended no changes to the current custom glide path which is shifted out five years from the State Street Global Advisors (SSgA) shelf glide path so that the most conservative allocation lands at retirement. This committee also reviewed the fee structure of the funds and recommended transitioning away from the retail mutual fund structure into a lower cost fund structure, like an Institutional Share Class or Commingled Investment Trust (CIT), if the firm has one available for the same strategy. The Fidelity Diversified International Equities Fund will have a CIT available some time during 4Q16 and the T. Rowe Price Small Cap Equity Fund offers an Institutional Share Class Fund. Lastly, this Deferred Compensation Review Committee recommended replacing the Janus Twenty Fund with the Vanguard Dividend Growth Fund. The Janus Twenty Fund is a relatively higher cost option that has underperformed its benchmark, the Russell 1000 Growth. Ms. Voss made a motion to endorse the Deferred Compensation Review Committee's recommendations and Mr. McDonald seconded the motion. The motion passed.

Andrew Krech provided a brief overview of the current alternative investment program and identified three funds staff was bringing before the committee to consider for new investment. Mr. Krech described IK Partners Fund VIII (Private Equity); Jon Stacy described Rockwood Capital Fund X (Real Estate), and Cassie Boll described LBC Credit (Credit). After discussion, Mr. McDonald moved approval of the three recommendations and Ms. Hacking seconded the motion. The motion passed.

Ms. Ann Posey and Mr. Jim Van Heuit reviewed the Asset Liability study conducted by Callan. Ms. Posey first walked through the objectives of the Asset Liability study, which were to evaluate the current asset allocation policy and determine if it was still appropriate considering the funding and benefit policies. The SBI is only responsible for the investment policy for the Combined Funds and the three statewide retirement systems are responsible for the funding and benefit polices for their respective plans. Public funds use the same rate to discount liabilities and to calculate expected investment return. This rate is selected by the legislature. Mr. Van Heuit reviewed the methodology and the assumptions for each of the asset allocation mixes provided.

After the Callan discussion, the Council discussed the aggressive nature of the equity orientation of the current and proposed asset mixes and its implications. It was pointed out that the asset allocation of most public funds tended to be aggressive, reflecting the longer term horizon of the funds. Mr. Perry then reviewed the recommendations and the implications of the changes. He stated that Staff would transition to the new policy over the course of Fiscal Year 2017. He also mentioned that additional proposals may be forthcoming which would modify the portfolio. Mr. Goodwin moved approval of staff's recommendation outlined in Tab F of the meeting materials as modified, and Ms. Hacking seconded the motion to adopt the following as it relates to the asset allocation policy:

1) Adopt the Combined Funds Asset Allocation Policy shown below:

	Combined Funds Asset Allocation
Public Equity	**58%**
Domestic Bonds	**20%**
Private Markets	**20%**
Cash	**2%**
Total	**100%**

2) Allocate the un-invested Private Markets allocation to Public Equities.

3) The Asset Class Target for Public Equities will be a composite index of the domestic equity asset class target, the Russell 3000 Index and the international equity asset class target, the MSCI ACWI ex USA Index. The current weighting of these two indices is 75% U.S. and 25% Non-U.S. The weightings will transition to a blend of 67% U.S. and 33% Non-U.S. by Fiscal Year 2018.

4) The U.S. equity portion of the Public Equities will continue to be benchmarked against the Russell 3000. The SBI will be authorized to invest in and benchmark U.S. Equity managers to the Russell 3000 Index or any of the Russell 3000 sub-indices that are segmented by market cap and by style such that the aggregation of the U.S. equity manager benchmarks are reflective of the Russell 3000 Index.

5) The Non-U.S. equity portion of the Public Equities will continue to be benchmarked against the MSCI ACWI ex USA Index. The SBI will be authorized to invest in and benchmark Non-U.S. equity managers to the MSCI ACWI ex USA (standard) Index or any of the MSCI ACWI ex USA sub-indices that are segmented by market cap, style, or geography such that the aggregation of the Non-U.S. equity manager benchmarks are reflective of the MSCI ACWI ex USA Index. Additionally, the SBI will be authorized to opportunistically invest in Non-U.S. equity managers that are benchmarked to the small cap segments of the MSCI ACWI.

6) Authorize the SBI to invest with Global Managers who invest in and are benchmarked to the MSCI ACWI or the MSCI World indices. The motion passed.

The meeting adjourned at 2:55 p.m.

Respectfully submitted,

Mansco Perry TO

Mansco Perry III
Executive Director and
Chief Investment Officer