



MINUTES

**Meeting of the Investment Committee
of the Board of Trustees of the
State Universities Retirement System
1:00 p.m. Thursday, February 4, 2010
Ennis Knupp & Associates
10 South Riverside Plaza
Chicago, Illinois 60606**

The following Trustees were present: Dr. J. Fred Giertz, Chair; Dr. Jeffrey Beaulieu, Ms. Patricia Cassidy, Dr. John Engstrom, Ms. Carrie Hightman, Ms. Dorinda Miller, Mr. Antonio Vasquez, and Mr. Mitchell Vogel.

Others present were: Ms. Judith A. Parker, Interim Executive Director; Mr. Daniel L. Allen, Chief Investment Officer; Mr. Douglas C. Wesley, Deputy Chief Investment Officer; Ms. Kimberly Pollitt, Senior Investment Officer; Ms. Lou Ann Fillingham and Mr. Tony Lee, Investment Officers; Ms. Marilyn Branson, Investment Governance and Compliance Officer; Ms. Lori Kern, Ms. Stacy Smith and Ms. Stefanie Rice, Executive Assistants; Ms. Mary Pat Burns, Burke, Burns & Pinelli; Mr. Russell Ivinjack, Ms. Laurel Nicholson, Mr. Mike Comstock, Mr. Matthew Russ, Ennis Knupp & Associates; Ms. Patti Somerville-Koulouris, The Northern Trust Company; Mr. Edgar Hernandez, Service Employees International Union; Ms. Mary Hobson, EFL Associates; and Mr. Barry Burr, Pensions & Investments.

Trustee Giertz called the meeting to order at approximately 1:00 p.m.

Roll call attendance was taken. Trustee Beaulieu, present; Trustee Berns, absent; Trustee Cassidy, present; Trustee Engstrom, present; Trustee Giertz, present; Trustee Hightman, absent (roll call taken prior to her arrival); Trustee Miller, present; Trustee Rogers, absent; Trustee Vasquez, present; Trustee Vogel, present; Trustee Williams, absent.

CHAIRPERSON'S REPORT

Trustee Giertz remarked that proceeds had recently been received from the sale of the State of Illinois pension obligation notes.

**REPORT FROM THE DECEMBER 1, 2009,
INVESTMENT COMMITTEE MEETING**

Mr. Daniel Allen introduced a new member to the investment team – Ms. Stefanie Rice, executive assistant to the Investment Department. Mr. Allen also announced that Mr. Joe Duncan has been hired to fill the investment officer position and that he will attend the Educational Forum on February 5, 2010.

It was noted that Ennis Knupp & Associates will conduct another session of EK University on February 18, 2010.

Mr. Allen’s memorandum entitled, “Report from the December 1, 2009, Investment Committee Meeting,” is incorporated as a part of these Minutes as [Exhibit 1](#). A copy of the memorandum entitled, “Investment Contracts Approved,” is incorporated as a part of these Minutes as [Exhibit 2](#).

APPROVAL OF MINUTES

Trustee Giertz presented the Minutes from the Investment Committee meeting of December 1, 2009. Trustee Engstrom moved that:

- The Minutes from the December 1, 2009, Investment Committee meeting be approved as presented.

Motion seconded and carried with all trustees present voting in favor.

Trustee Giertz presented the closed session Minutes from the October 20, 2009, and December 1, 2009, Investment Committee meetings. No discussions had. Trustee Engstrom moved that:

- The Minutes from the October 20, 2009, closed session Investment Committee meeting be approved and opened as presented.
- The Minutes from the December 1, 2009, closed session Investment Committee meeting be approved and opened as presented.

Motions seconded and carried with all trustees present voting in favor.

THE DECADE IN REVIEW FOR THE FINANCIAL MARKETS

Mr. Allen distributed a handout prepared by Mr. Douglas Wesley and Ms. Kimberly Pollitt entitled “A Decade in Review.” Mr. Allen summarized the document indicating that assets have been relatively flat, increasing to approximately \$12.5 billion dollars at the end of 2009. Liabilities have almost doubled, and the funding ratio has decreased to approximately 41.9% using the market value of assets method. Even though returns have

been volatile for the past decade, the investment performance for 2009 ended strongly at 23.1%. The ten-year return as of December 1999 was 12.4% whereas the ten-year return as of December 2009 is 3.4%. Approximately \$9.7 billion of benefits were paid during the past decade. Approximately \$4.3 billion of that amount was state appropriated money and approximately \$2.5 billion was member contributions. SURS funded the difference of approximately \$3 billion dollars from the investment program. A copy of staff's handout entitled, "A Decade in Review" is incorporated as a part of these Minutes as [Exhibit 3](#).

Discussion followed. Trustee Vogel requested a chart reflecting, for each of the last ten years, where the funds to pay benefits came from – state appropriation, member contributions or the investment program. Mr. Allen and Ms. Parker will coordinate to prepare a chart reflecting the same.

Mr. Allen concluded the Decade in Review by sharing that annual benefit payments have increased from \$590.2 million in fiscal year 2000 to \$1.4 billion in fiscal year 2009.

Trustee Carrie Hightman joined the meeting.

Mr. Russ Ivinjack and Ms. Laurel Nicholson presented to the Committee a broader review of financial markets in the past decade. Ms. Nicholson indicated that the last year of the decade ended on a high note. The US Stock market was up over 28%, the international markets were very strong and emerging markets were up nearly 8%. Ms. Nicholson commented that although there were several years of negative performance during the period, the overall return of the full decade was only slightly negative. Trustee Giertz noted that these charts should be reviewed in a long-term context. A copy of the presentation from Ennis Knupp entitled "Decade in Review" is incorporated as a part of these Minutes as [Exhibit 4](#).

Mr. Allen mentioned that the monthly investment update distributed in January shows a summary of the long-term performance of the fund.

**STATUS UPDATE REGARDING THE PUBLIC-PRIVATE INVESTMENT
PARTNERSHIP (PIIP) AGREEMENT WITH TRUST COMPANY OF THE
WEST (TCW)**

Mr. Allen announced there has been an organizational change in TCW. Since TCW was selected by the Board to manage a PPIP investment strategy, MetWest was acquired by TCW and Jeffrey E. Gundlach, TCW's Chief Investment Officer, was relieved of his duties. SURS is on the Advisory Committee of the TCW Special Mortgage Fund III. The U.S. Treasury made the decision to allow dissolution of the TCW fund. Staff recommends continuing with the PPIP investment strategy, reallocating TCW's assets among the three other Board approved PPIP managers – RLJ/Western, Oaktree Capital Management (Oaktree) and AG GECC (Angelo Gordon). Investing the recommended amounts will diversify SURS' investments. A copy of staff's memorandum entitled

“Recommendation Regarding Recent Events with TCW/Public-Private Investment Program” is incorporated as a part of these Minutes as [Exhibit 5](#).

There was discussion that with the distribution of the additional \$40 million, the Opportunity Fund will have a total commitment of \$160 million in PPIP strategies. Further discussion indicated that after the distributions, AG GECC will have a \$60 million allocation and RLJ/Western and Oaktree will have a total allocation of \$50 million each. The Trustees confirmed that the action taken today reallocating these funds from TCW was consistent with the Committee’s intent in October.

Trustee Beaulieu moved that reallocation of TCW Public-Private Investment Program (PPIP) Funds occur as follows:

- \$20 million be funded, contingent upon successful contract negotiations, to AG GECC Public-Private Investment Fund, L.P. or a parallel vehicle established for tax-exempt investors.
- \$10 million be funded, contingent upon successful contract negotiations, to RLJ/Western Asset Management Public/Private Fund, L.P. or a parallel vehicle established for tax-exempt investors.
- \$10 million be funded, contingent upon successful contract negotiations, to Oaktree PPIP Private Fund, L.P. or a parallel vehicle established for tax-exempt investors.

The motion was seconded and carried with all trustees present voting in favor.

The Trustees recommended that SURS resign from the TCW Special Mortgage Fund III Advisory Committee. Mr. Allen was directed to follow-up with a letter to TCW resigning from the advisory committee.

**FIXED INCOME ASSET CLASS OVERVIEW, FIXED INCOME AND
TREASURY INFLATION-PROTECTED SECURITIES (TIPS) ASSET CLASS
ANNUAL MANAGER REVIEWS**

Mr. Matt Russ from Ennis Knupp & Associates (EKA) presented an overview of the fixed income asset class to the Committee. Mr. Russ remarked on the role of fixed income in SURS investment program and discussed alternatives to reduce the volatility of a fixed income portfolio. One step to reduce volatility and to increase the liquidity of the fixed income portfolio would be to implement a passive bond strategy into the portfolio, which would provide enhanced liquidity and also serve as a funding source for benefit payments. EKA and staff recommended a search be initiated to identify a passive fixed income manager and that the existing fixed income managers be re-evaluated within the context of a formal search process. A copy of Ennis Knupp’s memorandum entitled “Fixed Income Asset Class Overview” is incorporated as a part of these Minutes as [Exhibit 6](#).

Ms. Kimberly Pollitt presented a report regarding the performance of the fixed income asset class. SURS has a target allocation of 21% for core fixed income and 5% for Treasury Inflation-Protected Securities (TIPS). SURS core fixed income portfolio returned 19.03% for the one-year period ending November 30, 2009, rebounding from 2008 levels. Ms. Pollitt advised that all active and structured active fixed income managers have outperformed their benchmarks in 2009. A copy of staff's memorandum entitled "Executive Summary of the Fixed Income Asset Class" is incorporated as a part of these Minutes as [Exhibit 7](#).

Ms. Pollitt noted the significant number of organizational changes that have occurred at the System's fixed income investment management firms, including PIMCO, BlackRock, Barclays Global Investors (BGI), Metropolitan West Asset Management and Western Asset Management. Of particular note was the December 1, 2009, acquisition of BGI by BlackRock Financial Management. As a result of this acquisition, BlackRock is now the world's largest asset manager with approximately \$3 trillion in assets. BlackRock manages nearly \$2.5 billion for SURS which constitutes approximately 20% of the total fund. Discussion followed regarding the long term impact of the acquisition on the new combined entity. Ms. Pollitt also informed the Committee of the pending acquisition of Metropolitan West Asset Management by TCW. A copy of EKA's memorandum entitled "Update on BlackRock's Acquisition of BGI," is incorporated as a part of these Minutes as [Exhibit 8](#). Copies of staff's memorandums entitled "PIMCO Fixed Income Manager Annual Review," "BlackRock Financial Management Annual Review," "Barclays Global Investors CoreActive Fixed Income Manager Annual Review," "Western Asset Management Fixed Income Manager annual Review," and "Metropolitan West Asset Management Fixed Income Manager Annual Review," are incorporated as a part of these Minutes as [Exhibit 9](#), [Exhibit 10](#), [Exhibit 11](#), [Exhibit 12](#), and [Exhibit 13](#), respectively.

Mr. Lee provided an update regarding the Manager Development Program TIPS search. Mr. Lee reported that the request for proposals for the search was issued on December 23, 2009. Finalist candidates will be reviewed within the next few weeks and staff will provide a recommendation to the Board at the March meeting. Mr. Allen remarked that the search is being conducted in accordance with the policy and procedures established by the Board. A copy of staff's memorandum entitled "SURS Manager Development Program TIPS Search Update" is incorporated as a part of these Minutes as [Exhibit 14](#).

The Trustees noted that the investment policy provides for annual review of investment managers and that continued retention of managers must be approved by the Board. In addition, Mr. Wesley observed that staff is recommending a search to evaluate the entire fixed income portfolio. Because of the numerous organizational changes mentioned previously, and the EKA recommendation to implement a passive component of approximately 20%, staff and EKA believe it is prudent to review each of the fixed income managers. If the search is approved, all current fixed income managers will be requested to rebid in order to retain their existing assignments, and a restructuring of the portfolio will occur as a result of the search process. Consideration of the need for a fixed income manager search followed.

Trustee Hightman moved that:

- PIMCO be retained as a core plus fixed income manager.
- PIMCO be retained as a TIPS fixed income manager.
- BlackRock be retained as a core plus fixed income manager.
- BlackRock Core Active (formerly BGI) be retained as an enhanced index fixed income manager.
- Western Asset Management be retained as a core plus fixed income manager.
- Metropolitan West Asset Management be retained as a core plus fixed income manager.
- Pugh Capital be retained as a core fixed income manager.
- Smith Graham be retained as a core plus fixed income manager.
- Taplin, Canida & Habacht be retained as a core plus fixed income manager.
- Davis, Hamilton, Jackson & Associates be retained as a core plus fixed income manager.
- The internally managed TIPS portfolio be retained.

The motion was seconded and carried with all trustees present voting in favor.

A copy of staff's memorandums entitled "Pugh Capital management Fixed Income manager Annual Review," "Smith Graham & Co. Investment Advisors Annual Review," "Taplin, Canida & Habacht Annual Review," and "Davis Hamilton Jackson & Associates, L.P. Annual Review" are incorporated as a part of these Minutes as [Exhibit 15](#), [Exhibit 16](#), [Exhibit 17](#), and [Exhibit 18](#), respectively.

RECOMMENDATION TO COMMENCE FIXED INCOME SEARCH

No additional recommendations were presented other than what was previously stated.

Trustee Hightman moved that:

- Searches be authorized to identify potential investment managers for both passive, and all active, core and core plus fixed income mandates.

The motion was seconded and carried with all trustees present voting in favor.

Copies of the memorandums entitled "Recommendation to Conduct Fixed Income Searches" and "Fixed Income Manager Search" are incorporated as a part of these Minutes as [Exhibit 19](#) and [Exhibit 20](#) respectively.

EDUCATION TOPIC – VALUE OF PASSIVE INVESTMENT MANAGEMENT STRATEGIES IN THE SURS INVESTMENT PROGRAM

Mr. Ivinjack introduced Mr. Mike Comstock of EKA who provided an educational session on passive investment strategies. A copy of EKA’s presentation entitled “SURS Trustee Education Forum: Passive Investment Strategies” is incorporated as a part of these Minutes as [Exhibit 21](#).

CONSIDERATION OF REQUEST FOR CONSENT TO ASSIGNMENT OF ADVISORY CONTRACT WITH METROPOLITAN WEST ASSET MANAGEMENT

Mr. Allen explained that when an organizational change occurs at an investment management firm, the Investment Management Agreement requires consent by the investor. Metropolitan West Asset Management (MetWest) has been acquired by TCW. At the conclusion of the transaction, which is anticipated to close by February 11, 2010, MetWest will own 10% of TCW. There are no concerns with the investment management capabilities of MetWest at this point. Mr. Allen indicated he has confidence in the current structure of MetWest. Trustee Vogel noted that SURS invests with MetWest, not TCW. Mr. Wesley mentioned that SURS will be continuing discussions with MetWest individuals and the Committee will be notified if there are any additional organizational changes. A copy of the memorandum entitled “Metropolitan West Asset Management (MetWest) Consent” is incorporated as a part of these Minutes as [Exhibit 22](#).

Mr. Allen indicated that a watch list is prepared every June and every December with letters sent to the managers that are on this list. The Trustees requested a watch list to be provided with each agenda for each meeting as an informational update to the Trustees.

Trustee Vasquez moved that:

- Consent to the assignment of the existing Investment Management Agreement with Metropolitan West Asset Management be approved pending legal review.

The motion was seconded and carried with all trustees present voting in favor.

A copy of Ennis Knupp’s memorandum entitled “MetWest Organizational Change” is incorporated as a part of these Minutes as [Exhibit 23](#). A copy of the memorandum from MetWest entitled “MetWest to be Acquired by TCW” is incorporated as a part of these Minutes as [Exhibit 24](#). A copy of a letter dated December 15, 2009, is incorporated as a part of these Minutes as [Exhibit 25](#).

**STATUS REPORT OF PENSION OBLIGATION NOTE FINANCING AND
FUNDING PLAN FOR INVESTMENT OF PROCEEDS**

Mr. Wesley noted that SURS proceeds of approximately \$550 million from the sale of the State of Illinois pension obligation notes on January 20, 2010. Of that amount, \$200 million was designated to pay benefits in February and March. The remaining \$350 million was used to rebalance SURS portfolio. A copy of staff's memorandum entitled "Receipt of Proceeds from Pension Obligation Notes Transaction" is incorporated as a part of these Minutes as [Exhibit 26](#).

INFORMATIONAL ITEMS NOT REQUIRING COMMITTEE ACTION

The following items were provided for reference and are incorporated as a part of these Minutes:

1. [Exhibit 27](#) - SURS Funding Status 2010 Fiscal Year-to-Date Results
2. [Exhibit 28](#) - Letter to Mitchell Vogel from the Office of the Illinois State Treasurer dated January 8, 2010
3. [Exhibit 29](#) - Memorandum entitled "Compliance Update"
4. [Exhibit 30](#) - Investment Compliance Activities 2010
5. [Exhibit 31](#) - SURS and Ennis Knupp & Associates Fiscal Year 2010-11 Work Plan
6. [Exhibit 32](#) - Schedule of Formal Reviews for SURS Investment Managers, Defined Benefit Plan & SMP
7. [Exhibit 33](#) - Memorandum entitled "Schedule of Investment Committee Meetings"

There being no further business to come before the Committee, Trustee Berns moved that the meeting be adjourned. The motion was seconded and carried.

Respectfully submitted,



Ms. Judith A. Parker
Interim Executive Director

JAP:ssr